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In The

Supreme Court of the United States

October Term, 1993

RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware,

Petitioner,

v.

OLDE DISCOUNT CORPORATION,

Respondent.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether a federal court may enjoin a state securities commissioner from ordering restitution for investor victims on the grounds that private parties have contracted away the state's enforcement remedy which is authorized by statute.

2. Whether a federal court, rather than abstain under the *Younger* doctrine, may enjoin a state securities commissioner from ordering restitution for investor victims in advance of the state's administrative hearing on the grounds that an alleged securities law violator's Federal Arbitration Act preemption claim is subject to an "immediate irreparable injury."

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PETITION FOR A WRIT OF CERTIORARI

The Delaware Securities Commissioner, Richard W. Hubbard, respectfully petitions this Court to grant a writ of certiorari to review the opinion and judgment of the United States Court of Appeals for the Third Circuit in this case.[1]

[1] W. Michael Tupman, Eugene H. Engelhardt, and Carol D. Engelhardt were also parties to this action in the court of appeals. Petitioner does not believe that they have an interest in this petition. Petitioner, contemporaneous with the filing of this petition, has served upon them the notice required by SUPREME COURT RULE 12.4.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Third Circuit is reported at 1 F.3d 202 (3d Cir. 1993) and is reprinted in the Appendix at 1. The order of the court of appeals denying the securities commissioner's petition for rehearing is reprinted at App. 46. The opinion of the United States District Court for the District of Delaware, reported at 805 F. Supp. 1130 (D. Del. 1992), is reprinted at App. 48. The order of the district court enjoining the securities commissioner is reprinted at App. 75.

JURISDICTION

The opinion and judgment of the court of appeals affirming the district court's preliminary injunction were entered on July 30, 1993. (App. 1). A timely motion for rehearing was denied on August 26, 1993. (App. 46). This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1). In granting the preliminary injunction against the securities commissioner, the district court determined that it had jurisdiction under 28 U.S.C. § 1331.

STATUTORY PROVISIONS INVOLVED

The two critical state and federal statutory provisions and the Supremacy Clause of the Constitution are stated below. Additional provisions of the Delaware Securities Act referenced in this petition are reprinted at App. 89.

Section 7325(b) of the Delaware Securities Act, as amended, DEL. CODE ANN. tit. 6, § 7325(b) (1992 Cum. Supp.), reads as follows:

> (b) The Commissioner may make, amend and rescind rules, regulations, forms and orders to carry out and define the provisions of this chapter. Such orders may provide for fines, assessment of costs, restitution to investors, conditional or probationary registration, censure or reprimand, special reporting requirements, or other provisions which the Commissioner determines to be in the public interest. Any person, whether registered or not, who wilfully violates any provision of this chapter, or who aids and abets any person who wilfully violates any provision of this chapter, may be fined in accordance with subsection 7316(g) and ordered to pay restitution and costs (or to rescind the transaction or transactions and pay costs) if the Commissioner finds it in the public interest, and may be criminally prosecuted under § 7322.

Section 2 of the Federal Arbitration Act, as amended, 9 U.S.C. § 2 (1970), reads as follows:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

The Supremacy Clause of the United States Constitution provides that:

> This Constitution, and the Law of the United States which shall be made in pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. CONST., art. VI, cl. 2.

STATEMENT OF THE CASE

On August 17, 1992, the Delaware Securities Division issued administrative charges against Olde Discount Corporation (Olde) and one of its agents alleging violations of the Delaware Securities Act (Act). (App. 7). The administrative complaint sought to suspend Olde's and the agent's registrations, impose fines for each violation of the Act, and rescind the underlying allegedly fraudulent sales. (App. 87). Eight days later, on August 25, 1992, without requesting a hearing on the administrative complaint, Olde filed an action in federal district court alleging violations of its federal rights by the Delaware securities commissioner and the Division's staff counsel. (App. 8). On September 16, 1992, the district court issued a preliminary injunction against the securities commissioner, enjoining him from seeking or ordering rescission on behalf of the complaining investors. (App. 8-9). The court ruled that because those investors had signed an arbitration agreement with Olde, the Federal Arbitration

Act (FAA) preempted the securities commissioner from seeking rescission as a remedy in his enforcement action. (App. 72-74). The commissioner appealed, and on July 30, 1993, a fragmented panel of the Court of Appeals for the Third Circuit, with one judge dissenting, affirmed. (App. 3) .

The record in this case consists of affidavits and supporting documents submitted within 48 hours of the filing of the original complaint and prior to the district court's hearing on Olde's motion for a temporary restraining order and preliminary injunction. (App. 49). On those documents, and without any live testimony, the district court in its memorandum opinion of September 16, 1992 made numerous findings of fact, some of which were erroneously labeled "undisputed."[2] (App. 49).

1. The Englehardts' Complaint

Olde Discount Corporation is a securities firm that maintains a branch office in Wilmington, Delaware. Olde has been registered as a broker-dealer in Delaware since October 1981. (App. 50). Although the firm holds itself out as a discount broker, it makes a market in many

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[2] For example, although the investors told the Securities Division investigator that the agent checked the investment objective of "speculation" without their knowledge after they had signed the account agreement, the court found as an undisputed fact that they had provided this information to the agent. (App. 51).

securities which its agents recommend to customers.[3] In 1983, Eugene and Carol Engelhardt opened a joint account with Olde in Michigan where they were then living. When the Engelhardts moved to Delaware in 1986, they transfered the account to Olde's office in Wilmington. (App. 50). In the spring of 1990, their account was assigned to Michael Donohoe, the sole agent and branch manager of the Wilmington office. (App. 50).

The administrative complaint alleged that Donohoe repeatedly recommended that the Engelhardts purchase common stock in a savings bank, Second National Federal Savings Bank (SNFS).[4] The Engelhardts, who were 56 and 50 years old, were initially reluctant to follow Donohoe's advice because they had invested most of their savings into certificates of deposit and some stocks personally selected by Mr. Engelhardt. (App. 81). Donohoe persisted, however, telling the couple that it was a local bank, and he was thus personally knowledgeable about the stock. Donohoe also said that the research report done by Olde's analysts gave the stock a "big buy recommendation." At another time, Donohoe told the Engelhardts that he had "inside knowledge" that SNFS was about to be bought by another bank. Donohoe went so far as to say, "I'll even waive the commission" to induce them to

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[3] The court of appeals' conclusion that Olde makes a market in only "a few selected stocks" is incorrect. (App. 4). An advertising brochure entitled "Modern Investing" that Olde sent to Delaware residents in or about August 1993 listed approximately 128 over-the-counter stocks in which Olde made a market.

[4] SNFS was a Maryland building and loan association until 1987, when it converted its charter to a federal savings bank.

make the purchase. (App. 82). Though Donohoe repeatedly sang the praises of SNFS, he did not tell the Engelhardts that Olde actually made a market in SNFS. (App. 83). Olde was thus on the other side of the transaction from the Engelhardts, selling the stock out of its own inventory with an undisclosed price mark-up. The apparently neutral recommendation from Donohoe was tainted by a conflict in interest, and the undisclosed fact that Olde was a market maker in the stock was a material omission in violation of DEL. CODE ANN. tit. 6, § 7303(2). (App. 83).

The Engelhardts were eventually won over by Donohoe's importuning. On May 15, 1990, they bought 2000 shares of SNFS stock at 5¼ per share for $10,622, and then an additional 3000 shares at 5⅜ for $16,308. Donohoe marked the trade tickets as "unsolicited." (App. 83). Ten days later, after the two initial purchases of SNFS stock, and several years after they had started doing business with Olde, the Engelhardts were asked by Donohoe to sign an "Investors Account Agreement," which they did. Prior to May 25, 1990, there was no written agreement. (App. 50).

2. The Arbitration Agreement And Further Sales

Although the signature portion of the Agreement, which was a single two-sided piece of paper, referred to a "Predispute Arbitration Clause," the actual arbitration clause was in the form of a printed brochure separate from the signature page. It provided that the investors had to submit "any and all controversies or claims arising

out of the relationship established by this agreement to arbitration to be conducted according to the rules and procedures of the New York Stock Exchange, Inc. (NYSE) or of the National Association of Securities Dealers, Inc. (NASD)." (App. 4).

After the intitial sales and the signing of the Agreement, Donohoe continued to urge the Engelhardts to purchase more SNFS shares. Donohoe claimed the thrift was "strong" and that he "knew of things going on," alluding to a potential acquisition of SNFS shares by another bank, which would make their purchase of SNFS shares "a really good deal." (App. 84). On Donohoe's recommendation, the Engelhardts bought another 5000 shares of SNFS common stock on June 6, 1990 at $5^1/_4$ per share for $26,250. Donohoe marked the trade ticket as "unsolicited." (App. 84).

Shortly thereafter, the stock price began to drop, and it continued to fall as SNFS lost $16 million in income during the quarter ending September 30, 1990. (App. 80). By the end of 1990, SNFS stated in its Form 10-K financial report that it was in violation of capital requirements and in danger of a regulatory takeover. (App. 81). During this period, Donohoe never apprised the Engelhardts of these events but, in response to a call from Mr. Engelhardt, encouraged them not to sell the stock. (App. 86). The Engelhardts lost most of the value of their investment as the share price of SNFS plummeted. (App. 80).

3. The Investigation, Draft Notice, And Settlement Negotiations

In July 1991, the Engelhardts filed a complaint with the Delaware Securities Division against Olde and Donohoe. (App. 52). The Division's investigator made written inquiries to Olde and Donohoe. (App. 52-53). After the investigation was completed in May 1992, the Securities Division staff counsel forwarded to Olde's counsel a draft of the "Notice of Intent To Suspend or Revoke Broker-Dealer Registration." (App. 53). The notice, which if filed would trigger an administrative proceeding, charged that Olde and Donohoe had engaged in fraudulent, dishonest, and unethical practices in connection with the sales of the SNFS stocks to the Engelhardts. (App. 83-85). In addition, it charged Olde with failing to supervise Donohoe reasonably. (App. 84, 86).

In an effort to settle the charges, counsel for Olde and the Securities Division discussed the complaint for several months. In July 1992, Olde offered a $20,000 settlement that would have paid the investors less than half of their investment loss.[5] (App.6). As negotiations broke down, Olde served a demand for arbitration on the Engelhardts. (App. 7). After the collapse of settlement efforts, the Securities Division staff counsel

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[5] The district court found that this offer would have fully compensated the Engelhardts for their loss during the period when they had an account with Olde, (App. 54, 56), overlooking the fact that there was subsequently no market for the stock, making it effectively worthless.

recommended that the administrative notice be issued.[6] On August 17, 1992, the commissioner issued the notice of intent to suspend or revoke the registrations of Donohoe and Olde in Delaware.[7] (App. 57).

4. Olde's Action And The Decisions Below

Rather than defend itself on the administrative charges, Olde filed an action in federal district court on August 25, 1992, naming the securities commissioner, staff counsel, and the investors as defendants. The original complaint alleged, *inter alia*, that Delaware's administrative rescission remedy was preempted by the FAA and

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[6] The district court found that the draft notice sought a $10,000 fine for each violation of the Act, (App. 53), but the notice that was issued on August 17, 1992 sought only a $1000 fine for each violation. (App. 87).

[7] The Delaware Department of Justice issued a brief press release on August 17 reporting the initiation of proceedings against Olde. A newspaper article appeared on August 18 in the Wilmington *News Journal*, and in response to that article, Securities Division staff received additional complaints similar to those made by the Engelhardts. On December 7, 1992, Securities Division staff counsel recommended the issuance of a second administrative complaint, charging Olde and Donohoe with further violations committed in the sale of SNFS stock to 17 investors in Delaware. Also on December 7, 1992, the commissioner issued the second notice of intent to suspend or revoke the registration of Olde and Donohoe. The violations alleged in the second notice involved conduct similar to that which was alleged in the first administrative complaint.

that Olde's federal civil rights were violated by the defendants.[8] (App. 8).

On the basis of affidavits submitted soon after the filing of Olde's complaint, the district court issued its September 16, 1992 memorandum opinion with detailed findings of fact concerning the investment by the Engelhardts and the settlement negotiations between Olde and the Securities Division staff attorney. (App. 48). The court accepted Olde's argument as to an identity of interest between the Engelhardts and the State, and the court enjoined the securities commissioner from seeking or ordering rescission on behalf of the Englehardts. (App. 71, 75). According to the district court, the FAA preempted § 7325(b) of the Delaware Securities Act, DEL. CODE ANN. tit. 6, § 7325(b) (1992 Cum. Supp.), as that statutory provision allowed the commissioner to order rescission on behalf of individual investors who had signed predispute arbitration agreements. (App. 74).

The defendants appealed the preliminary injunction to the Third Circuit Court of Appeals, which issued its decision on July 30, 1993.[9] (App. 1). The court split three

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[8] Subsequently, on January 26, 1993, the complaint was amended to allege violations of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961-1968, by the Delaware Division of Securities, which was alleged to be a criminal enterprise that engages in criminal extortion.

[9] In the district court and on appeal the Delaware Department of Justice provided representation to the Engelhardts, as witness victims who were being sued, pursuant to its specific duty under 29 DEL. CODE ANN. §2504(9). Judge Greenberg thought this fact confirmed the "community of interest" between the Securities Division and the Engelhardts for purposes of preemption analysis. (App. 17).

ways: Judge Greenberg affirmed on the basis of preemption; Judge Rosenn concurred on the grounds that contract principles supported the district court's actions to prevent the Engelhardts from an "end run" to evade their contractual obligations; and Judge Nygaard dissented on the grounds that the Delaware statutory scheme made the commissioner's enforcement action in the public interest a different type of action than a civil suit by the Englhardts in their own interest. (App. 3). The panel agreed, however, that *Younger* abstention did not apply. (App. 3). The defendants then filed a petition for rehearing, which was denied on August 26, 1993. (App. 46).

As the preliminary injunction has been under appeal, the administrative action has been stayed for the past year while Olde pursues its RICO and civil rights claims on the other counts in the district court. The parties are now in the midst of discovery.

REASONS FOR GRANTING THE WRIT

This case presents a conflict between strong federalism concerns and arbitration rights under the Federal Arbitration Act (FAA): may private parties contractually invalidate a state regulatory agency's statutory remedy for securities law violations? Attempting to deal with this question, the court of appeals has issued a fractured, three-way decision that promises to confuse and mislead the other circuits. It is also a major departure from this Court's approach in the important areas of arbitration and abstention. The court of appeals' decision held that

the FAA precludes state regulators from seeking a remedy that would benefit a victim in the same manner as would an arbitration award. Ironically, two judges on the panel below agreed that the state agency was not preempted under the FAA; yet, the district court's injunction, which was based on preemption analysis, was affirmed. Moreover, the concurring opinion was grounded in contract law, but it ignored the most fundamental contract principle: an entity that is not a party or in privity with a party to a contract cannot be bound by the terms of the agreement.

The issues in this case extend beyond the administrative remedy in question and beyond the area of securities law. Four states have administrative restitution or rescission provisions similar to Delaware's.[10] Twenty-six other states have provisions in their securities acts specifically authorizing the agency to seek court-ordered rescission,[11] while three additional state statutes allow the agency to seek disgorgement.[12] Most of the remaining states have adopted § 408 of the Uniform Securities Act, 1 Blue Sky L. Rep. (CCH) ¶ 5548, allowing the agency to seek ancillary

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[10] *See* ARIZ. REV. STAT. ANN. § 44-2032(1) (1987) and ARIZ. COMP. ADMIN. R. & REGS. § 14-4-308; D.C. CODE ANN. § 2-2614 (1981); IND. CODE ANN. § 23-2-1-17.1(a) (Burns 1993 Cum. Supp.); and VA. CODE ANN. § 13.1-521(c) (1993).

[11] These states are: Alabama, California, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Maine, Massachusetts, Mississippi, New Mexico, New York, North Carolina, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Texas, Utah, Vermont, Washington, and Wisconsin.

[12] *See* ARK. CODE § 23-42-209(b) (1987); MICH. COMPL. LAWS § 451.808(a) (1979); TENN. CODE ANN. § 48-2-119(b) (1988).

relief in connection with the granting of an injunction.[13] Such ancillary relief has been interpreted to include restitution and rescission.[14]

Since bank credit card agreements have begun to include arbitration clauses, the court of appeals' decision also bears directly on state consumer protection law. The rationale of the two affirming opinions below would apply to any consumer protection action brought by a state attorney general seeking restitution if the consumer victims had agreed to an arbitration clause.[15] It would also seem to extend to court-ordered restitution in a criminal case (for example, securities fraud under DEL. CODE ANN. tit. 6, § 7322, a different section of the same statute under which the Securities Division brought the instant administrative action). This important issue in federal law should not be determined by a confusing opinion that blatantly disregards this Court's holdings in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. ___, 111 S.Ct. 1647, 114 L.Ed.2d 26, 38, 41 (1991) (EEOC may prosecute action and seek equitable relief on basis of complaint that is also subject of arbitration); *Porter v. Warner Holding Co.*, 328 U.S. 395, 402 (1946) (restitution in the public interest is not the equivalent of damages

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[13] This Act has been adopted in 41 states and territorial jurisdictions. *See* 1 Blue Sky L. Rep. (CCH) ¶ 5500 (1992).

[14] *See, e.g., Porter v. Warner Holding Co.*, 328 U.S. 395 (1946); *Mitchell v. Robert De Mario Jewelry, Inc.*, 361 U.S. 288 (1960); *State ex rel. Day v. Southwest Mineral Energy, Inc.*, 617 P.2d 1334 (Okla. 1980). *See also* 12A J. LONG, BLUE SKY LAW § 9.05[6] (1992).

[15] Rescission is a form of restitution. D. DOBBS, REMEDIES 222 (1973). The petitioner interprets the district court's preliminary injunction as barring restitution orders generally.

sought by a private party, even where the facts are the same); *Kelly v. Robinson*, 479 U.S. 36, 52 (1986) (restitution distinguishable from damages judgment for private individual); *Ohio Civil Rights Commission v. Dayton Christian Schools, Inc.*, 477 U.S. 619, 627-28 (1986) (*Younger* abstention applies even where federal right would have to be asserted in state administrative proceeding); and *New Orleans Public Service, Inc. v. Council of City of New Orleans*, 491 U.S. 350, 365 (1989) (preemption claim is no different than other constitutional claims for purposes of *Younger* abstention).

The Delaware Securities Act

Historically, the states have exercised their police powers to regulate securities to protect the investing public. "State securities laws, commonly referred to as 'blue sky' laws, were enacted long before the Securities Act of 1933, and Congress specifically preserved those laws instead of attempting to preempt the field from federal legislation." L. Loss & E. Cowett, Blue Sky Law 3 (1958). Both the Securities Act of 1933 and the Securities Exchange Act of 1934 expressly preserve the traditional rights of the states to regulate securities transactions within their own jurisdictions. *See* 1933 Act, 15 U.S.C. § 77r (1981); 1934 Act, 15 U.S.C. § 78bb(a) (1981 & 1992 Cum. Supp.). Accordingly, there is a presumption that in enacting the FAA, Congress did not intend to preempt the regulatory power of the states to enforce their securities laws to protect the public interest.

The Delaware Securities Act (Act) is a "blue sky" law which "with some specificity . . . requires registration of

securities offered or sold [in Delaware], states that certain representations are unlawful, creates a registration procedure for broker-dealers and investment advisors, and provides for administration by the Attorney General or a designated Deputy." *Singer v. Magnavox Co.*, 380 A.2d 969, 981 (Del. 1977). The purpose of the Act is "to prevent the public from being victimized by unscrupulous or overreaching broker-dealers, investment advisers or agents in the context of selling securities or giving investment advice, as well as to remedy any harm caused by securities law violations." DEL. CODE ANN. tit. 6, § 7301(b). The statute contains one section that permits civil damages to a private litigant from a person who "offers, sells or purchases a security" by fraud. DEL. CODE ANN. tit.6, § 7323(a). In addition to that limited private civil cause of action, the Act creates an administrative regulatory scheme and bestows broad enforcement powers on the securities commissioner. "In the public interest," the commissioner may 1) seek an injunction in Delaware's Court of Chancery (§ 7320), 2) seek a criminal indictment (§ 7322), or 3) "by order deny, suspend, or revoke any registration" in an administrative proceeding (§ 7316). As a sanction for a proven state law violation, in an administrative proceeding under § 7316, the commissioner is authorized to impose, *inter alia*, an award of rescission or restitution in the public interest. DEL. CODE ANN. tit. 6, § 7325(b). Similarly, the Court of Chancery, in an injunctive proceeding brought by the commissioner, may order rescission or restitution when appropriate in the public interest. DEL. CODE ANN. tit. 6, § 7320. And, in any criminal prosecution under the Act, the Superior Court may

similarly order restitution to defrauded investors as part of the sentence. DEL. CODE ANN. tit. 6, § 7322(e).

In this case, the Securities Division initiated an administrative action under § 7316 and § 7325(b) before the commissioner. Although a private civil action under §7323 by investors (such as the Engelhardts) is precluded by an arbitration agreement under the FAA, the commissioner's public enforcement action under § 7316 and § 7325(b) should not be preempted.

I. The Court Should Grant The Writ To Clarify That A Federal Court May Not Enjoin A State Securities Commissioner From Ordering Restitution For Investor Victims On The Grounds That Private Parties Have Contracted Away The State's Enforcement Remedy Which Is Authorized By Statute.

The court of appeals' holding effectively creates a new, super-protected federal right to arbitrate. It overrides the *Younger* abstention doctrine as well as a statutorily-authorized remedy under a state regulatory scheme. This case marks the first time that FAA rights have been successfully asserted, not to deflect state interference with the arbitration forum,[16] but to assert the primacy of arbitration rights over any possible arguable

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[16] *See, e.g., Securities Industry Ass'n v. Connolly*, 883 F.2d 1114 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990) (FAA held to preempt Massachusetts regulation prohibiting brokers from requiring investors to sign an arbitration agreement as condition of opening an account); *Osterneck v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 841 F.2d 508 (3d Cir. 1988) (FAA held to preempt Pennsylvania Securities Act provision that precluded enforcement of agreement to arbitrate state law securities claims).

conflict in outcome between arbitration and a neutral state regulatory procedure. In this case, the Delaware statute did not even mention or address arbitration. Under the court of appeals' decision, the arbitration right is superior to all other contract rights and, indeed, to constitutional rights.

A. Restitution Is Not Equivalent To A Judgment For Damages.

Both the preemption and the "contractually bound" rationales of the two opinions which affirm the injunction rest on the unsound assumption that the rescission which the commissioner could order in the public interest is nothing more than the same remedy the Engelhardts could seek in an arbitration forum. As this Court has held, however, restitution in the public interest differs greatly from damages sought by private parties. *Porter v. Warner Holding Co.*, 328 U.S. 395, 402 (1946). Indeed, in *Porter* this Court upheld an award of restitution to overcharged tenants in an action by a government price control administrator even though the tenants themselves could not have brought their own actions to recover the same payments. The action undertaken in the public interest was not the same as a private cause of action. More recently, in *Kelly v. Robinson*, 479 U.S. 36, 52 (1986), this Court stated that even though "restitution does resemble a judgment 'for the benefit of' the victim, the context in which it is imposed undermines that conclusion. The victim has no control over the amount of the restitution awarded or over the decision to award restitution."

B. The Court Of Appeals' Departure From Gilmer.

The court of appeals' approach is also contrary to this Court's statement in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. ___, 111 S.Ct. 1647, 114 L.Ed.2d 26 (1991), that administrative agencies, enforcing the public interest, are free to pursue issues and fashion remedies even though the transaction in question may also fall within an arbitration agreement. This Court held in *Gilmer* that an arbitration agreement between a securities representative and his employer required the employee to arbitrate a statutory claim under the Age Discrimination in Employment Act (ADEA); but the contractual clause did not preclude the employee from filing a complaint with the Equal Employment Opportunity Commission (EEOC) alleging the same statutory violation, nor did it "preclude the EEOC from bringing actions seeking class-wide and equitable relief." 114 L.Ed.2d at 41. This is because "the ADEA is designed not only to address individual grievances, but also to further important social policies." *Id.* at 38. Thus, "[a]n individual ADEA claimant subject to an arbitration agreement will still be free to file a charge with the EEOC, even though the claimant is not able to institute a private judicial action." *Id.*

Like the EEOC, the Delaware securities commissioner "does not function simply as a vehicle for conducting litigation on behalf of private parties." *Occidental Life Insurance Co. v. EEOC*, 432 U.S. 355, 368 (1977). *See also General Telephone Co. v. EEOC*, 446 U.S. 318, 326 (1980) ("When the EEOC acts, albeit at the behest of and for the benefit of specific individuals, it acts also to vindicate the

public interest in preventing employment discrimination."). The commissioner acts on behalf of the public when he awards restitution or rescission in favor of a defrauded investor. Such remedies, as they return the parties to the *status quo*, help to deter and eliminate the harmful consequences of securities fraud. These objectives are explicitly defined as part of the "public interest" by the Delaware General Assembly in the Delaware Securities Act. DEL. CODE ANN. tit. 6, § 7301(b). While these remedies may give an incidental compensatory benefit to the individual investors, such relief does not give them control of the regulatory action or make their interests equivalent to the State's broader interest in protecting the investing public from securities fraud. Under the Delaware scheme, the private investors do not control whether their complaint will be investigated, whether a prosecution will eventually be initiated, what remedies the Division will seek, or what remedies the commissioner and reviewing courts may impose. Suits by government regulators "frequently have specific private as well as public beneficiaries," but the "touchstone remains the fact that public policies are served and the public interest is advanced by the litigation, and the fact that the litigation has private beneficiaries as well does not detract from the public nature of the suit." *Dole v. Local 427*, 894 F.2d 607, 612 (3d Cir. 1990).

C. Rescission Does Not Render The Arbitration Agreement Meaningless.

The gist of the two affirming opinions in the court of appeals is that the contractual right to arbitrate will be

meaningless if the Delaware commissioner in a regulatory action may order rescission on the same facts that might be the basis of an arbitration. That view is incorrect, however, legally and practically. From a legal perspective, the agreement to arbitrate runs only against those who were parties to the contract. From a practical perspective, a brokerage firm may still derive a substantial benefit from an arbitration agreement even if it remains subject to state-ordered rescission in the public interest.

The great benefit of an arbitration agreement is the savings in the cost of litigating in an arbitration forum rather than in a judicial lawsuit. This benefit is especially valuable to a large brokerage firm with many clients. Inevitably, such a firm will be faced with meritless claims based on the fact of a client's loss and nothing more. These are the sort of claims that, if they end up in prolonged court battles, can financially damage a business significantly regardless of the level of care taken by its managers. The state regulators, however, exercise a screening function to weed out the frivolous complaints, the sour grapes, and the fodder for nuisance suits. Unlike private attorneys who may see a large contingency fee in these meritless complaints, the state regulators have no personal financial interest in advancing them. Thus, the real benefit of an arbitration agreement as a practical matter is its effect on litigation initiated by private parties, not on actions which may be initiated by state government officials. It is appropriate that the scope of this practical benefit be limited to those who have agreed to it, the private parties themselves.

D. The Right To Arbitrate Is Equal, Not Superior, To Other Contract Rights.

The FAA was intended by Congress "to make arbitration agreements as enforceable as other contracts, but not more so." *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395, 404 n.12 (1967). The FAA "simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms." *Volt Information Sciences, Inc. v. Stanford University*, 489 U.S. 468, 478 (1989).

One of the most elementary of contract principles is that a third party not in privity to a contract between two others is not bound by the terms of their agreement. Here, the securities commissioner never agreed to be bound by the terms of any contract between Olde and the Engelhardts. Moreover, the commissioner and the Engelhardts were not in privity, nor did they have an identity of interest. The court of appeals mischaracterized the administrative proceeding, saying that it was "initiated on the complaint of the Engelhardts," and that the State "is pursuing" civil claims "on behalf" of the Engelhardts. (App. 17). In fact, the Engelhardts' complaint triggered only an investigation by the Securities Division. The Division made the decision whether to file a notice (with the commissioner's approval), and the commissioner and reviewing state courts would make the decision whether an order of rescission would be necessary to protect the public interest. As Judge Nygaard stated in dissent, "[T]he Delaware statutory scheme makes clear that the Commissioner is not a surrogate for

a plaintiff's attorney, but is a public official who administers the state's blue sky laws 'in the public interest' and is endowed with broad enforcement and rulemaking powers." (App. 38, citing *Blinder, Robinson & Co. v. Bruton*, 552 A.2d 466, 475 (Del. 1989).)

E. There Is A Strong Public Interest In The Remedies Of Rescission And Restitution.

Although the lower courts have focused on the remedy of rescission, the Olde arbitration agreement itself did not. Rather, the contract stated that "any and all controversies or claims arising out of the relationship" had to go to arbitration. (App. 4). On its face, this language would extend to any hearing involving the same factual dispute as would be involved at an arbitration. Both lower courts in this case have held, however, that this language does not preclude a hearing that would result in a finding that Olde and Donohoe violated the Delaware Securities Act and in the imposition of a license suspension or a fine, but does preclude making the victims whole. The logic of this distinction, permitting parallel proceedings for some sanctions but not restitution, is elusive. This Court has held that a public interest inheres in the remedy of restitution just as it does in the remedies of a license suspension or a fine. *See Kelly v. Robinson*, 479 U.S. 36, 52 (1986); *Porter v. Warner Holding Co.*, 328 U.S. 395, 402 (1946).

Not only does case law support the view that restitution is a necessary enforcement remedy that advances the public interest, but practical considerations do as well. The public interest may be better served by reducing or

avoiding the more severe sanction of a license suspension or revocation. If a state securities administrator's hands are tied by the federal courts with respect to making victims whole through an order of restitution, brokerage firms may risk a greater chance of receiving a license suspension or, if restitution is available only in criminal prosecutions, of being prosecuted criminally. Through their flawed decision, the federal courts will have skewed decisionmaking among state securities regulators in a manner detrimental to the public interest.

II. The Court Should Grant The Writ To Clarify That A Federal Court May Not Enjoin A State Securities Commissioner From Ordering Restitution For Investor Victims In Advance Of The State's Administrative Hearing On The Grounds That An Alleged Securities Law Violator's Federal Arbitration Act Preemption Claim Is Subject To An "Immediate Irreparable Injury."

This case illustrates the utter disregard by the Court of Appeals for the Third Circuit of the *Younger v. Harris*, 401 U.S. 37 (1971), abstention doctrine, especially as it was articulated by this Court in *Ohio Civil Rights Commission v. Dayton Christian Schools, Inc.*, 477 U.S. 619, 627-28 (1986), and *New Orleans Public Service, Inc. v. Council of City of New Orleans*, 491 U.S. 350, 365 (1989) (*NOPSI*). In the instant case, the court of appeals has held that *Younger* abstention is discretionary even when all elements that normally counsel abstention are present. (App. 25). Moreover, the court of appeals has effectively violated this Court's instruction in *NOPSI* that preemption claims

are to be treated no differently than other constitutional claims for purposes of abstention under *Younger.*

To avoid application of the *Younger* doctrine, here the court of appeals carved out a new exception for FAA preemption claims. The court tried to avoid the impact of *NOPSI* by asserting that that decision "did not confront a collision between the normal application of *Younger* principles and the highly favored right to arbitration which the [Supreme] Court itself has developed in FAA cases. . . . "(App. 30). Thus, even though this Court views preemption claims as similar to other constitutional claims for abstention purposes, the court of appeals thinks this principle does not apply to FAA claims that possibly have merit. Apparently, in its view, the right to arbitrate has acquired a status that is superior to such rights as due process and equal protection. Reaching for authority for this anomalous proposition, the court of appeals cites *Wooley v. Maynard,* 430 U.S. 705 (1977), to assert that this case is the "very unusual situation" where "an injunction is necessary to prevent great and immediate irreparable injury." (App. 25, quoting *Dayton Christian Schools,* 477 U.S. at 626). The great and immediate irreparable injury, it seems, is the fact that Olde would have to assert its FAA preemption defense at the state administrative proceeding and in the reviewing state courts. However, this Court in *Dayton Christian Schools* held that this type of alleged injury is insufficient to avoid application of *Younger* abstention. 477 U.S. at 627-28.

CONCLUSION

For the foregoing reasons, this Court should grant this petition for a writ of certiorari.

Respectfully submitted,

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APPENDIX

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Filed July 30, 1993

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 92-7557

OLDE DISCOUNT CORPORATION

v.

W. MICHAEL TUPMAN, and as Deputy Attorney General of the State of Delaware; RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware; EUGENE H. ENGELHARDT and CAROL D. ENGELHARDT,

W. MICHAEL TUPMAN, individually and as Deputy Attorney General of the State of Delaware; RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware; EUGENE H. ENGELHARDT, CAROL D. ENGELHARDT,

Appellants

On Appeal from the United States District Court
for the District of Delaware

(D.C. Civil No. 92-00498)

Argued June 10, 1993

BEFORE: GREENBERG, NYGAARD, and ROSENN,
Circuit Judges

(Filed: July 30, 1993)

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OPINION

GREENBERG, *Circuit Judge.*

This case presents a novel question of the relationship between a contracting party's right to enforcement of an arbitration agreement under the Federal Arbitration Act, 9 U.S.C. §§ 1-16 (FAA), and a state's interest in pursuing a remedy of rescission in an administrative proceeding. The district court enjoined the Delaware securities commissioner from seeking rescission on behalf of two investors who had entered into a predispute arbitration agreement. We will affirm the district court's order. Judge Greenberg votes to affirm on the grounds that the FAA preempts Delaware's rescission remedy in these circumstances and this opinion reflects the reasons why he has reached this conclusion. Judge Rosenn votes to affirm on the ground that the rescission remedy is barred by reason of contract law as set forth in his separate concurring opinion. Judge Nygaard dissents on this issue for the reasons set forth in his separate opinion. We unanimously hold that this claim, *i.e.*, that a state statute is preempted to the extent it authorizes relief in conflict with rights secured by the FAA, necessarily falls within an exception to the abstention doctrine of *Younger v. Harris*, 401 U.S. 37, 91 S.Ct. 746 (1971).

I. BACKGROUND

Appellee Olde Discount Corporation, a securities broker-dealer, is a Michigan corporation with its principal

place of business in Detroit and numerous offices throughout the United States. Olde Discount is registered in Delaware as a broker-dealer and has an office in Wilmington. Appellants Eugene and Carol Engelhardt are former customers of Olde Discount. The Engelhardts, then Michigan residents, opened a brokerage account with Olde Discount's Detroit office in 1983. When they moved to Wilmington in 1986, the Engelhardts transferred their account to its Wilmington office.

Olde Discount is primarily, as its name implies, a discount broker. It also makes a market in a few selected stocks; at the times relevant to this action, Second National Federal Savings Bank (SNFS) was among those stocks. Allegedly at the instance of Olde Discount's Wilmington office manager, Michael Donohoe, the Engelhardts purchased 5,000 shares of SNFS stock on May 15, 1990. On May 25, 1990, the Engelhardts signed an account agreement with Olde Discount that required them "to submit any and all controversies or claims arising out of the relationship established by this agreement to arbitration to be conducted according to the rules and procedures of the New York Stock Exchange, Inc. (NYSE) or of the National Association of Securities Dealers, Inc. (NASD). . . . " Investors Account Agreement, ¶ 18, J.A. at 53. Also on May 25, 1990, the Engelhardts provided Olde Discount with a "customer preference profile" that expressed their interest in "aggressive" investments for the purposes of "growth" and "speculation." J.A. at 48. On June 6, 1990, the Engelhardts purchased an additional 5,000 shares of SNFS. Thus, by early June 1990, the Engelhardts had purchased 10,000 shares of SNFS. These purchases cost the Engelhardts over $50,000.

The price of SNFS stock declined steadily during the summer and fall of 1990, as the bank suspended its dividend and came under the scrutiny of federal regulators because it failed to fulfill capital requirements. The Engelardts, apparently because of their bad experience with this investment, terminated their Olde Discount brokerage account and removed their SNFS shares from Olde Discount on September 6, 1990. By then the Engelhardts' SNFS stock had declined in value to approximately $32,500.

Nearly a year later, in July 1991, the Engelhardts first contacted the Division of Securities of the Delaware Department of Justice with a complaint about their purchase of SNFS stock from Olde Discount. The Division, primarily through appellant Michael Tupman, a Delaware Deputy Attorney General responsible for securities law enforcement, investigated the Engelhardts' complaint. In early June 1992, after the Division substantially had completed its investigation, it sent Olde Discount a draft "Notice of Intent to Suspend or Revoke Broker-Dealer Registration." The draft Notice of Intent alleged that Olde Discount and its agent Donohoe had engaged in fraudulent and unethical practices in connection with the sales of SNFS stock to the Engelhardts, in violation of Del. Code Ann. tit. 6, §§ 7303(2) and 7316(a) (1974 & Supp. 1992).

In particular, the Notice asserted that Donohoe repeatedly had urged the Engelhardts to invest in SNFS and had made false statements of material fact about the stock. Further, the Notice alleged that Olde Discount had not kept the Engelhardts advised of information that could have been pertinent to their decision whether to

hold or sell the stock. The Notice indicated that the Delaware securities commissioner sought the remedies of suspension or revocation of Olde Discount's broker-dealer registration and imposition of fines; and, central to the preemption question in this case, that the commissioner would seek rescission of the SNFS stock transactions between Olde Discount and the Engelhardts, as authorized by Del. Code Ann. tit. 6, § 7325(b). The Notice, however, did not suggest that either Olde Discount or Donohoe had violated any duty to customers other than the Engelhardts; the Notice thus proposed individual relief for the Engelhardts only.

During the summer of 1992, the Division of Securities and Olde Discount tried to negotiate a settlement of the proposed charges. Ultimately Olde Discount, desiring to bring the settlement negotiations to fruition, offered to pay $15,000 to the Delaware Investors Protection Fund and to pay $20,375 to the Engelhardts.[1] The proposed payment to the Engelhardts represented the difference between the total price they had paid for the SNFS stock, and its value of approximately $32,500 on September 6,

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[1] In their opening brief, the appellants asserted that the district court's consideration of events that occurred during settlement negotiations was contrary to Fed. R. Evid. 408, which prohibits the admission of "[e]vidence of conduct or statements made in compromise negotiations. . . . " However, as counsel for Olde Discount has noted, the appellants have not preserved this evidentiary point because they did not object to the introduction of these facts before the district court. In any event, these facts are background information, helpful to an understanding of the context of the dispute; they are not critical to our disposition, as we anchor our result on legal principles.

1990, when the Engelhardts had closed their brokerage account with Olde Discount.

The appellants do not dispute that Tupman agreed in principle to accept $15,000 in partial settlement of the Division's proposed charges. Nevertheless, Tupman insisted that Olde Discount also must rescind the Engelhardts' SNFS purchases. This demand was not acceptable to Olde Discount, which apparently had consistently maintained that the securities commissioner could not properly pursue a rescission, because Olde had a contractual right to arbitrate the Engelhardts' claims. Tupman, however, viewed Olde Discount's claims of its contractual right to arbitration and of the federal preemption of Delaware's rescission remedy as "baffling." *See* Tupman's August 7, 1992 letter to Olde Discount, J.A. at 111. He consequently would not abandon the demand that it rescind the SNFS sales to the Engelhardts.

Olde Discount determined to pursue its right to arbitration, and served the Engelhardts with a demand to arbitrate on August 5, 1992. Shortly thereafter, on August 17, 1992, Tupman issued the Notice of Intent in substantially the same form as the June 1992 draft, *i.e.*, including the demand for rescission of the Engelhardts' SNFS transactions. Notice of Intent, ¶ 43, J.A. at 139. The Notice provided that Olde Discount would be entitled to a hearing before the Delaware securities commissioner if it made a written request within 30 days. However, if Olde Discount did not request a hearing, the allegations would be deemed admitted and the commissioner would issue a final order of suspension, revocation, rescission, fine and/or costs.

On August 25, 1992, Olde Discount commenced this action against Tupman, Delaware Securities Commissioner Richard W. Hubbard, and the Engelhardts. The complaint's four counts alleged that: (1) the rescission remedy of Del. Code Ann. tit. 6, § 7325(b), as applied by the defendants, circumvents Olde Discount's rights under the FAA and thus violates the Supremacy Clause; (2) the application of Del. Code Ann. tit. 6, § 7325(b), to Olde Discount's transactions with the Engelhardts in SNFS stock would constitute an *ex post facto* punishment in violation of the Due Process Clause;[2] (3) Tupman and Hubbard had violated 42 U.S.C. § 1983 by employing the Delaware securities laws in a manner that impaired Olde Discount's federal constitutional and statutory rights; and (4) Tupman's actions constituted a common law abuse of process. Olde Discount sought an injunction, a declaratory judgment, compensatory damages, and punitive damages.

Olde Discount most immediately was concerned with preserving its federal right to arbitration of the Engelhardt dispute. It therefore vigorously pressed for a preliminary injunction to halt further proceedings before the Delaware Division of Securities. After expedited briefing and argument, the district court, by order dated September 16, 1992, accompanied by a comprehensive memorandum opinion, partially granted Olde Discount's motion for preliminary relief, enjoining "the Securities

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[2] Olde Discount contends that at the time of its transactions with the Engelhardts, Delaware law did not provide for a rescission remedy in proceedings concerning suspension or revocation of the registration of a broker.

Commissioner[] [from pursuing] a rescission action under [Del. Code Ann. tit. 6, § 7325(b)] on behalf of defendants Engelhardt, individual investors who are parties to a predispute arbitration agreement with plaintiff, which agreement is enforceable under the Federal Arbitration Act, 9 U.S.C. §2." In its opinion, the district court determined that the FAA preempted the Delaware rescission remedy. Furthermore, the district court declined to abstain under *Younger* from issuing injunctive relief. Tupman, Hubbard, and the Engelhardts jointly appealed from the September 16, 1992 order, contending that the district court "erred as a matter of law" both in declining to abstain under *Younger* and in holding that the rescission remedy was preempted.

II. JURISDICTION AND STANDARD OF REVIEW

Before turning to the merits of the preemption and abstention issues, we must resolve a challenge to our jurisdiction raised by Olde Discount. It argues that the appeal is from an interlocutory order "directing arbitration to proceed," which is specifically nonappealable under 9 U.S.C. § 16(b)(2). However, contrary to Olde Discount's characterization, the district court's order in this case is not an order "directing arbitration to proceed." Rather, the district court directed the Delaware securities commissioner not to pursue a remedy of rescission in the administrative proceedings. Thus, the order falls within the usual rule of 28 U.S.C. § 1292(a)(1), which permits immediate appeals from "[i]nterlocutory orders . . . granting [or] refusing . . . injunctions."

Our review of a determination regarding preliminary injunctive relief is limited to examining whether the district court abused its discretion, committed an obvious error in applying the law, made a clear mistake in considering the proof, or improperly applied the law to the facts. *Kreimer v. Bureau of Police of Morristown*, 958 F.2d 1242, 1250 n.9 (3d Cir. 1992); *Philadelphia Marine Trade Ass'n v. Local 1291, Int'l Longshoremen's Ass'n*, 909 F.2d 754, 756 (3d Cir. 1990), *cert. denied*, 111 S.Ct. 953 (1991). This standard requires a plenary review here, as the appellants contend that the district court erred as a matter of law in entering the injunction. We also exercise plenary review over the abstention question because we are resolving that issue by making a legal determination. *General Glass Indus. Corp. v. Monsour Medical Found.*, 973 F.2d 197, 200 (3d Cir. 1992); *Gwynedd Properties, Inc. v. Lower Gwynedd Township*, 970 F.2d 1195, 1199 (3d Cir. 1992).

III. PREEMPTION

The Supremacy Clause allows Congress to preempt state legislation if it so intends.[3] *See United States Dep't of Treasury v. Fabe*, 61 U.S.L.W. 4579 (U.S. June 11, 1993). The development of the law of federal preemption has defined three ways of discerning a congressional intent to preempt state law: express or explicit preemption, implied preemption, or "actual conflict" preemption. The

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[3] While as a matter of convenience this section of the opinion entitled "III. PREEMPTION" is written as if for the court, it in fact is the opinion only of Judge Greenberg.

Supreme Court thus has differentiated among the three types of preemption:

> Congress explicitly may define the extent to which its enactments pre-empt state law. . . . In the absence of explicit statutory language, however, Congress implicitly may indicate an intent to occupy a given field to the exclusion of state law. Such a purpose properly may be inferred where the pervasiveness of the federal regulation precludes supplementation by the states, where the federal interest in the field is sufficiently dominant, or where 'the object sought to be obtained by the federal law and the character of obligations imposed by it . . . reveal the same purpose'. . . . Finally, even where Congress has not entirely displaced state regulation in a particular field, state law is pre-empted when it actually conflicts with federal law. Such a conflict will be found ' "when it is impossible to comply with both state and federal law . . . or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress. . . . " '

Schneidewind v. ANR Pipeline Co., 485 U.S. 293, 299-300, 108 S.Ct. 1145, 1150-51 (1988) (citations omitted).

The preemption claim before us is that the FAA demands enforcement of an agreement to arbitrate which cannot be abrogated by a state agency's pursuit of an administrative remedy that would duplicate the remedy sought in an arbitration. Section 2 of the FAA, 9 U.S.C. § 2, directs the enforcement of arbitration agreements as broadly as Congress' powers under the Commerce Clause permit:

> A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Olde Discount contends that the FAA's directive compels enforcement of the arbitration clause of the Engelhardts' account agreement. Thus, if the Delaware securities commissioner pursues rescission in the administrative proceeding, Olde Discount's federal right to arbitration would be impaired, as the merits of the claim that the arbitration agreement reserves for an arbitral forum will be resolved administratively.

Yet it is clear that the FAA does not explicitly preempt any particular remedy that might be sought in state administrative proceedings. Nor does the FAA entirely occupy the field of securities regulation so as to give rise to implied preemption; to the contrary, both the Securities Act of 1933 and the Securities Exchange Act of 1934 specifically preserve the traditional rights of the states to regulate securities transactions within their own jurisdictions. *See, e.g.*, 1933 Act, 15 U.S.C. § 77r ("[n]othing in this subchapter shall affect the jurisdiction of the securities commission . . . of any State or Territory . . . over any security or any person"); 1934 Act, 15 U.S.C. § 78bb(a) ("[n]othing in this chapter shall affect the jurisdiction of the securities commission . . . of any State over any

security or any person insofar as it does not conflict with the provisions of this chapter"). In fact the FAA is not concerned in particular with securities regulation as 9 U.S.C. § 2 deals generally with contracts involving commerce. Therefore, to preserve its right to a meaningful arbitral forum Olde Discount relies on the third type of preemption, "actual conflict" preemption.

There can be "actual conflict" preemption in two circumstances, either where it is impossible to comply with the conflicting demands of federal and state statutes, or where the state law is an "obstacle" to the fulfillment of the congressional purposes embodied in the federal law. *See, e.g., Florida Lime & Avocado Growers, Inc. v. Paul,* 373 U.S. 132, 83 S.Ct. 1210 (1963) (holding federal regulation concerning maturity of avocados did not preempt California regulation, where it was not impossible for growers to comply with both regulations); *Hines v. Davidowitz,* 312 U.S. 52, 67, 61 S.Ct. 399, 404 (1941) (holding federal Alien Registration Act preempted Pennsylvania Alien Registration Act because state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress"); *Pennsylvania Medical Soc'y v. Marconis,* 942 F.2d 842, 848 (3d Cir. 1991) (holding Pennsylvania statute governing limited aspects of Medicare billing not preempted by federal Medicare Act because state statute did not create obstacle to fulfillment of Congress' objectives). As our analysis of the interaction between the Delaware administrative rescission remedy and Olde Discount's arbitration agreement with the Engelhardts will make clear, both factors indicating conflict preemption, conflicting statutory demands

and an obstacle to Congress' purposes, are present in this case.

The context of this preemption claim, *i.e.*, the preservation of a federal right to an arbitral forum, is critical. At one time other substantive and procedural rights of parties were thought to outweigh a right to arbitration. *See Wilko v. Swan*, 346 U.S. 427, 74 S.Ct. 182 (1953) (stating Securities Act of 1933 precluded waiver of judicial forum, rendering arbitration agreement invalid). But that time is no more. *See Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 109 S.Ct. 1917 (1989) (overruling *Wilko v. Swan*). The Supreme Court unstintingly has promoted a favorable climate for arbitration through vigorous enforcement of the FAA over the last 20 years. The gradual erosion of the principles of *Wilko v. Swan* began with the 1974 decision of *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 94 S.Ct. 2449, which held that a claim under the Securities Exchange Act of 1934 would be arbitrable in the distinctive context of an international business transaction. The international character of the dispute was also an important consideration in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 105 S.Ct. 3346 (1985), which upheld an order compelling submission of Sherman Act claims to arbitration in Japan. More generally, *Mitsubishi* noted that there is "no warrant in the Arbitration Act for implying in every contract within its ken a presumption against arbitration of statutory claims." *Id.* at 625, 105 S.Ct. at 3353.

The Court moved beyond the specialized international context and enforced arbitration of 1934 Act claims and RICO claims, pursuant to a clause in a standard brokerage agreement, in *Shearson/American Express, Inc. v.*

McMahon, 482 U.S. 220, 107 S.Ct. 2332 (1987). Shortly thereafter, the Court resolved the inconsistency between *McMahon* and *Wilko* by expressly overruling *Wilko* in *Rodriguez de Quijas*. Two Terms later, the Court extended the ascendancy of arbitration beyond commercial disputes to age-discrimination claims in *Gilmer v. Interstate/Johnson Lane Corp.*, 111 S.Ct. 1647 (1991), which rejected the contention that the involvement of an agency, there the Equal Employment Opportunity Commission, in a scheme of enforcement created any impediment to the private arbitration of the claims arising in a particular case.

Two aspects of the development of the federal right to arbitration that we have traced are particularly noteworthy here. First, the arbitration of securities disputes now is not only permitted, but favored, under federal law, according to the line of decisions culminating in *McMahon* and *Rodriguez de Quijas*. *See also Osterneck v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 841 F.2d 508 (3d Cir. 1988) (stating FAA preempts provision of Pennsylvania Securities Act purporting to preclude enforcement of agreements to arbitrate state law securities claims). Second, there is no longer any doubt that statutory claims are arbitrable, and the existence of an enforcing agency, as in *Gilmer*, does not interfere with the arbitrability of individual claims. Similarly, it is clear that state statutory claims, as well as federal statutory claims, are subject to the federal right to an arbitral forum. *See Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852 (1984) (holding FAA preempts California statutory provision requiring judicial forum for claims under California Franchise Investment Law); *Osterneck v. Merrill Lynch*, 841 F.2d at 512-13.

Thus, the claims that the Delaware Division of Securities is pursuing on behalf of the Engelhardts, *i.e.*, claims of fraudulent dealings in violation of Del. Code Ann. tit. 6, § 7303, certainly would be subject to arbitration if pursued by the Engelhardts themselves. *See* Del. Code Ann. tit. 6, § 7323 (creating private right of action for securities fraud). However, the appellants argue that for preemption purposes we must distinguish between the advancement of essentially identical claims on the basis of whether their proponent is a state agency or a private litigant. The appellants contend that the state's enforcement action implicates the public interest, and not simply the rights of the Engelhardts. Further, the appellants cite *Gilmer* for the proposition that "arbitration agreements will not preclude [an administrative agency] from bringing actions seeking class-wide and equitable relief." 111 S.Ct. at 1655. In the appellants' view, the agency's pursuit of "equitable relief" sanctioned in *Gilmer* should include the remedy of rescission of specific trades of securities sought in this case. The appellants view the rescission remedy as an integral component of the state's regulation of securities transactions which, they argue, should not be weakened by the application of federal preemption.

However, we think the rescission remedy as applied here necessarily would render Olde Discount's right to arbitration meaningless. The particular remedy therefore must fall before the conflicting right to an arbitral forum granted by the FAA. The FAA's fundamental purpose was to create "a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24, 103 S.Ct.

927, 941 (1983). "In enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland Corp. v. Keating*, 465 U.S. at 10, 104 S.Ct. at 858. Yet the Delaware Division of Securities claims that it must be permitted to adjudicate administratively the very same questions regarding Olde Discount's sale of SNFS stock to the Engelhardts, that the Engelhardts themselves could pursue only within an arbitration. In that regard, Delaware has interfered with Olde Discount's right under the FAA to resolution of these issues through arbitration. Therefore, in the application here of the rescission remedy of Del. Code Ann. tit. 6, § 7325(b), Delaware has created an "obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. at 67, 61 S.Ct. at 404.

The very community of interest between the state appellants and the Engelhardts implicitly demonstrates that the administrative proceedings are an obstacle to Congress' purpose in adopting the FAA. Clearly the Engelhardts are relying on the state appellants to obtain a remedy that would frustrate the arbitration. As the appellants acknowledge, the administrative proceedings were initiated on the complaint of the Engelhardts. Indeed, the Notice of Intent issued to Olde Discount was concerned exclusively with dealings between Olde Discount and the Engelhardts. Furthermore, Tupman filed this appeal on behalf of the Engelhardts, who are not represented by separate counsel on appeal, and were not so represented in the earlier settlement negotiations with Olde Discount.

In the circumstances, the state administrative proceedings, to the extent they concern claims and liabilities between the Engelhardts and Olde Discount, are nothing other than a substitute for the arbitration.

The circumstance that the state appellants are not parties to the arbitration clause does not alter our result. As the Supreme Court explained in *Moses H. Cone Memorial Hospital*, "[u]nder the Arbitration Act, an arbitration must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement." 460 U.S. at 20, 103 S.Ct. at 939. In partial reliance on *Moses H. Cone*, we recently upheld a district court's eviction of a subtenant to facilitate an award arising from an arbitration between the property owner and the tenant, even though the subtenant was not a party to the arbitration. *See Isidor Paiewonsky Assocs. v. Sharp Properties, Inc.*, No. 92-7337 (3d Cir. June 24, 1993).[4]

It is also apparent that, in any practical sense, Olde Discount cannot simultaneously arbitrate its claims against the Engelhardts and defend against the Delaware securities commissioner's pursuit of the rescission remedy in an administrative proceeding. Notwithstanding the appellants' statement that they will not, and cannot, prevent Olde Discount from commencing the arbitration, the appellants' view of a possible harmonious interaction of the state and federal statutes is illusory. While in a physical sense Olde Discount could be represented in two

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[4] We are not suggesting that an award in an arbitration proceeding would be preclusive in administrative proceedings; that issue is not presented by this appeal.

proceedings at once, the potential for actual conflict in that scenario is manifest. If an arbitration panel decides that the Engelhardts' claims are without merit and Olde Discount has no liability to them, while the Delaware securities commissioner concludes that the SNFS purchases must be rescinded, the results of the proceedings will be irreconcilable.

Even if the two proceedings were to reach similar results on the merits, Olde Discount still would be deprived of its right to the presumed simplicity and efficiency of the arbitral forum. Thus, to the extent rescission is involved, it is impossible to fulfill the demands of both the federal and state statutes. Therefore, Delaware's pursuit of the rescission remedy is preempted by the FAA both because Del. Code Ann. tit. 6, § 7325(b) presents an obstacle to the accomplishment of the congressional purpose of enforcing arbitration agreements, and because it is impossible to give effect to both the administrative rescission remedy and the federal right to arbitration.

We also reject the appellants' contention that an administrative rescission remedy is not preempted because *Gilmer* sanctions "equitable relief" by an agency despite a parallel arbitration of private claims. First, *Gilmer* on its facts did not address a question of equitable relief and its statements thereon are not dispositive of how the Supreme Court might resolve an actual controversy involving private arbitration and an agency's "equitable" remedies. Second, we believe the precise statement in *Gilmer, i.e.*, "that arbitration agreements will not preclude the EEOC from bringing actions seeking class-wide and equitable relief," 111 S.Ct. at 1655, was meant to draw a distinction between private remedies

available in arbitration for one employee, versus remedies available through an action of the EEOC for a group of employees. In other words, the reference in *Gilmer* to class-wide equitable relief apparently was directed toward a situation where the EEOC could bring its enforcement powers to bear against an employer violating the law in its dealing with numerous employees by, for example, seeking an injunction on behalf of a class of employees against future acts of age discrimination. The analog in our case would be that the Delaware Division of Securities, if convinced that Olde Discount has committed widespread violations beyond those alleged in relation to the Engelhardts' stock purchases, is free to protect Delaware investors by imposing fines or licensing restrictions on Olde Discount, regardless of the progress or outcome of any arbitration of the Engelhardts' claims.[5] Thus, there is no foundation for appellants' assertion that *Gilmer* establishes that the state's interest in the "equitable" remedy of rescission should be given special exemption from standard preemption principles.

While our analysis might be different if a finding of preemption were to work a substantial interference with

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[5] It is conceivable that in the case of widespread violations of uniform character, *e.g.*, the distribution of fraudulently issued securities, individualized relief for members of a victimized class of customers might be possible notwithstanding the presence of arbitration agreements, on a theory that the violation did not arise from the particular relationship between the customer and the broker. We, of course, state no opinion on that possibility as it is not before us. In this case, the Notice of Intent was predicated on Olde Discount's and Donohoe's alleged individual maltreatment of the Engelhardts, which the Notice described in great detail.

traditional state objectives of securities law enforcement, that is not the case here. The district court did not enjoin the Delaware securities commissioner from investigating Olde Discount or from pursuing administrative remedies other than rescission of the Engelhardts' purchases. Accordingly, Delaware may take whatever action it sees fit consonant with federal law, concerning Olde Discount's state registration as a broker-dealer.[6] Delaware is also free to pursue individualized remedies, including rescission, as to securities transactions not subject to arbitration agreements.[7] Delaware therefore retains many avenues for the exercise of its proper role in dealing with alleged violations of its securities laws. Accordingly, federal preemption of the rescission remedy for investors

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[6] On December 7, 1992, the Division of Securities initiated a second proceeding against Olde Discount and Donohoe by reason of alleged improprieties in their dealings with other investors in SNFS stock. We are not concerned with those proceedings in this opinion.

[7] Although the appellants seem not to have stressed this point before the district court, the Engelhardts' initial purchase of 5,000 shares of SNFS stock on May 15, 1990, was before they signed the account agreement containing the arbitration clause on May 25, 1990. The district court did not take this sequence of events into account in reaching its result and neither will we as there is no issue as to the arbitrability of disputes arising from that purchase before us on this appeal. Nevertheless the district court's order of September 16, 1990, by its terms enjoins the commissioner from pursuing a rescission remedy for the May 15, 1990 purchase of SNFS stock. Thus, we do not preclude the appellants on remand from seeking an order modifying the preliminary injunction so as to exclude that purchase.

who have agreed to arbitration will narrow but not eliminate the state regulators' choices of means of enforcement of the Delaware securities laws.[8]

IV. ABSTENTION

The appellants argue, aside from the merits of the preemption question, that the district court should have abstained from granting an injunction that will interfere with Delaware's ongoing administrative proceedings against Olde Discount. The district court concluded that the abstention doctrine of *Younger v. Harris*, 401 U.S. 37, 91 S.Ct. 746, was not applicable to Olde Discount's preemption claim under the FAA. We agree with the district court's resolution. Indeed, the circumstances presented make clear that a nonfrivolous claim of FAA preemption of a state statutory remedy necessarily presents an exception to the *Younger* doctrine.

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[8] The amici curiae in their brief contend that the district court's opinion could have a major impact in "the criminal law area" because of an increasing tendency for courts to impose restitution as part of a sentence. They suggest that if we affirm the district court's order, the state "could not seek nor could the court grant such relief where the defendant had entered into an arbitration agreement with his victims." Brief at 8. We, of course, cannot rule on what the law would be in the situation the amici describe. However, it is apparent that a case involving a criminal conviction is distinguishable from that involved here. In this case the administrative proceeding was in part brought for the express purpose of obtaining a rescission remedy. On the other hand, a criminal case is brought to determine whether a defendant is criminally liable and, if so, to fix the penalty for the violation.

Younger established that, despite the assertion of claims based on the federal constitution or federal statutes, a federal court should not enjoin pending state proceedings where three elements are present: (1) the ongoing state proceedings are "judicial" in nature; (2) the proceedings implicate important state interests; and (3) the proceedings afford an adequate opportunity to raise the federal claims. *Middlesex County Ethics Comm. v. Garden State Bar Ass'n*, 457 U.S. 423, 432, 102 S.Ct. 2515, 2521 (1982). Nevertheless, the Supreme Court has emphasized that a court should abstain only in rare cases.

> The doctrine of abstention . . . is an extraordinary and narrow exception to the duty of a District Court to adjudicate a controversy properly before it. Abdication of the obligation to decide cases can be justified under this doctrine only in . . . exceptional circumstances. . . .

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. at 14, 103 S.Ct. at 936 (quotation marks omitted).

The Court recently reiterated the exceptional quality of abstention in *New Orleans Public Service, Inc. v. Council of New Orleans*, 109 S.Ct. 2506 (1989). The Court noted that abstention is confined to rare circumstances because it runs counter to "the proposition that federal courts lack the authority to abstain from the exercise of jurisdiction that has been conferred. . . . 'They cannot abdicate their authority or duty in any case in favor of another jurisdiction.' " *Id.* at 2512-13 (quoting *Chicot County v. Sherwood*, 148 U.S. 529, 534, 13 S.Ct. 695, 697-98 (1893)). Those principles enunciated in *New Orleans Public Service* guided our approach in *Gwynedd Properties, Inc. v. Lower Gwynedd Township*, 970 F.2d 1195. In *Gwynedd*, mindful

that "a federal court has no authority to abstain from the exercise of jurisdiction that has been properly conferred," *id.* at 1199, we partially reversed the district court's dismissal of a complaint alleging federal constitutional claims concerning municipal land use regulatory decisions that were concurrently the subject of state court and municipal zoning board proceedings.

Notwithstanding the strict limits of abstention, the doctrine, where appropriate, forbids injunctive interference with state administrative proceedings as well as state court proceedings, though *Younger* itself forbade an injunction against a state criminal prosecution. In *Middlesex County Ethics Committee,* which upheld a district court's refusal to enjoin a state bar disciplinary proceeding on the grounds that the New Jersey Supreme Court would review the plaintiff's federal constitutional claims, the Court made explicit that "[t]he policies underlying *Younger* are fully applicable to noncriminal judicial proceedings when important state interests are involved." 457 U.S. at 432, 102 S.Ct. at 2521. In *Ohio Civil Rights Commission v. Dayton Christian Schools, Inc.,* 477 U.S. 619, 106 S.Ct. 2718 (1986), the Court again endorsed *Younger* abstention in relation to an ongoing state administrative proceeding. In that case, a religious school sought a federal injunction on First Amendment free exercise grounds against the state's investigation of a sex-discrimination complaint. The Court found that the third requisite of the *Younger* doctrine, availability of an opportunity to raise federal claims, was provided because the school's "constitutional claims may be raised in state-court judicial review of the administrative proceeding." *Id.* at 629, 106 S.Ct. at 2724.

It is therefore clear that conceptually *Younger* abstention can apply to the situation raised by Delaware's administrative proceedings against Olde Discount. The investigation and pending hearing by the Delaware securities commissioner is an ongoing state proceeding, "judicial" in nature, within the meaning of *Younger, Middlesex County,* and *Dayton Christian Schools.* Delaware's proceeding also undoubtedly serves the important state interest of regulating securities transactions, insofar as such power of regulation is reserved to the states under both the Securities Act of 1933 and the Securities Exchange Act of 1934. *See* 15 U.S.C. §§ 77r, 78bb(a). Finally, even if the Delaware Division of Securities has reached a conclusion that its pursuit of a rescission remedy is not preempted by the FAA, under *Dayton Christian Schools* it would be sufficient that Olde Discount could raise its preemption arguments again in a review of the administrative proceedings by the Delaware Court of Chancery. *See* Del. Code Ann. tit. 6, § 7324(a).

However, our conclusion that this situation formally fits within a *Younger* framework does not end our abstention inquiry, for *Younger* abstention is not always appropriate even if its elements are present. Thus, if "a genuine threat of prosecution exists, a litigant is entitled to resort to a federal forum to seek redress for an alleged deprivation of federal rights." *Wooley v. Maynard,* 430 U.S. 705, 710, 97 S.Ct. 1428, 1433 (1977); *see also Dayton Christian Schools,* 477 U.S. at 626, 106 S.Ct. at 2722 (interpreting *Younger* to prevent injunctions against state proceedings "except in the very unusual situation that an injunction is necessary to prevent great and immediate irreparable injury"); *Harmon v. Forssenius,* 380 U.S. 528, 537, 85 S.Ct.

1177, 1183 (1965) (stating that district court properly refused to abstain "[g]iven the importance and immediacy of the problem, and the delay inherent" in awaiting guidance from state courts). We addressed a similar situation of immediate need for intervention by a federal court in *Ford Motor Co. v. Insurance Commissioner*, 874 F.2d 926 (3d Cir. 1989). There, various insurers brought a preemption challenge to a Pennsylvania statute that prohibited the insurers from owning interests in savings and loan institutions. We applied the counsel of *Wooley v. Maynard* to articulate an exception to the *Younger* doctrine for state civil as well as criminal proceedings, in instances where "deference to the state proceeding will present a significant and immediate potential for irreparable harm to the federal interests asserted." *Id.* at 932.

Delaware's insistence upon the rescission remedy presents just such an immediate potential for irreparable harm to Olde Discount's right under the FAA to an arbitral forum. The Delaware regulators have chosen to stand firm in their pursuit of administrative rescission despite Olde Discount's repeated invocation of the FAA, its efforts to commence an actual arbitration with the Engelhardts, and the district court's suggestion that the issue of rescission could be bifurcated from the state's determination concerning other proposed remedies.[9]

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[9] Tupman, appearing for the State at the district court's August 27, 1992 hearing, rejected any separation of the rescission question from the State's broader proceedings:

> THE COURT: Mr. Tupman, just a comment or two. I do have a question for you:

Indeed the very nature of arbitration demonstrates the irreparable harm Olde Discount faces, for its right to arbitration is a contractual right sanctioned by statute, to have claims addressed in a particular forum. Thus, if the district court abstained in this case it would not simply be declining to exercise its statutorily created jurisdiction, which is the usual consequence of abstention. Rather, it would be refusing to protect Olde Discount's access to the forum that it and the Engelhardts contractually selected to resolve their disputes.

Furthermore, Olde Discount's right to arbitration cannot be satisfied if an alternate administrative forum is determining at the same time whether a claim to the identical remedy is available. The concern underlying a federal right to enforcement of arbitration agreements is a party's entitlement to a proceeding and a forum that are, at least ideally, speedy, efficient, and simpler than litigation in the courts or before agencies. *See Rodriguez de Quijas*, 490 U.S. at 479-80, 109 S.Ct. at 1919; *Mitsubishi*, 473 U.S. at 628, 105 S.Ct. at 3354. Therefore, in the context of

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> Aside from Paragraph 42 of your notice of intent to suspend or revoke, is there any reason why the public regulatory part of the Commission's prosecution can't be bifurcated from the [rescission] remedy . . . ?
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> MR. TUPMAN:. . . . [S]ince the statute and the General Assembly do clearly contemplate that all of this will be resolved in a single administrative proceeding, I don't think that it is – serves any interest, since, as we contend there's no impairment of the arbitration agreement. If they want to go to arbitration, they can go to arbitration. I can't stop them.

Supplemental App. at 92-93.

arbitration, a litigant's procedural right to the agreed forum is raised to a substantive right by the FAA. Accordingly, if Olde Discount were forced to address rescission of its sales to the Engelhardts in an administrative proceeding, even if it simultaneously could pursue an arbitration, it would suffer an immediate, irreparable harm to the federal right established by the FAA.

We find authority that *Younger* abstention would be inappropriate here in *Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852. In *Southland* the Supreme Court determined to take jurisdiction over the appeal precisely because of the immediacy of the harm suffered by a party denied a right to arbitration. The California Supreme Court had held that the FAA did not preempt a California statute requiring a judicial forum for certain franchise claims, and had remanded the case to the state trial court for a disposition on the merits. Despite the remand, which arguably rendered the state court's decision not final, the Supreme Court took jurisdiction, reasoning that "[c]ontracts to arbitrate are not to be avoided by allowing one party to ignore the contract and resort to the courts. Such a course could lead to prolonged litigation, one of the very risks the parties, by contracting for arbitration, sought to eliminate," 465 U.S. at 6-8, 104 S.Ct. at 856-57. In this case, abstention would have precisely the same consequence, *i.e.*, it would permit the Engelhardts' claims to be brought before the Delaware securities commissioner, thus circumventing the agreement to arbitrate. We think *Southland* teaches that the federal courts ought not countenance such frustration of the FAA's mandate.

We also point out that abstention in this case would be difficult to justify in light of the congressional intent

reflected in 9 U.S.C. § 16. That section provides that while orders compelling arbitration are not immediately appealable, orders denying motions to compel arbitration or to stay judicial proceedings pending arbitration are immediately appealable. This dichotomy reflects the paramount importance that Congress has placed on arbitration. In effect, Congress has given the courts of appeals broad authority to ensure that district courts are not circumscribing the rights granted by the FAA in a manner contrary to the expansive enforcement of arbitration clauses that has been dictated by Congress itself and by the Supreme Court in, *e.g.*, *McMahon*, *Rodriguez de Quijas*, and *Gilmer*.

We are mindful that generally a claim of federal preemption, in and of itself, is not entitled to more deferential treatment than other constitutional claims in the face of an abstention challenge. The Supreme Court said as much in *New Orleans Public Service:*

> There is no greater federal interest in enforcing the supremacy of federal statutes than in enforcing the supremacy of explicit constitutional guaranties, and constitutional challenges to state action, no less than preemption-based challenges, call into question the legitimacy of the State's interest in its proceedings reviewing or enforcing that action. Yet is clear that the mere assertion of a substantial constitutional challenge to state action will not alone compel the exercise of federal jurisdiction.

109 S.Ct. at 2516.

In *New Orleans Public Service*, the Court ultimately found that the district court should not have abstained.

However, the Court did not conclude that simply because the case implicated findings of the Federal Energy Regulatory Commission which preempted a decision of local rate-making authorities, a blanket exception to *Younger* principles was warranted. *See also Ford Motor Co.*, 874 F.2d at 934 ("there is no absolute rule prohibiting the application of *Younger* abstention doctrine whenever the Supremacy Clause is invoked").

But in *New Orleans Public Service*, the Court did not confront a collision between the normal application of *Younger* principles and the highly favored right to arbitration which the Court itself has developed in FAA cases from *Scherk v. Alberto-Culver* through *Rodriquez de Quijas* and *Gilmer*. The collision is imminent in the present case, and we must resolve it by application of the Supreme Court's FAA cases and the Court's recognition in *Wooley v. Maynard* that, even when the *Younger* doctrine strictly might be applicable, a threat of immediate, irreparable harm to federal rights can warrant an injunction against state proceedings. We think that where, as here, a state agency is engaged in a course of action openly inconsistent with a litigant's rights under Section 2 of the FAA, that litigant cannot be turned away from federal court by an invocation of *Younger* abstention. This very narrow exception to *Younger* will not create difficulties in cases involving frivolous or weak claims of FAA preemption, because such claims would not meet the traditional requisites for injunctive relief and thus will not even require a district court to reach a *Younger* challenge.[10]

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[10] In its opinion, the district court cited *Instant Air Freight Co. v. C.F. Air Freight, Inc.*, 882 F.2d 797, 800 (3d Cir. 1989), with

We make one final point. A district court's decision to abstain does not necessarily mean that a federal court will never consider the proffered federal claim. Rather, abstention delays the review by a federal court until a state forum has had an opportunity to pass on the issue. For example, if a criminal prosecution is claimed to violate federal free speech, free exercise, or due process rights, a defendant not satisfied by the state court's resolution of those claims ultimately can seek a federal forum by petition for certiorari or petition for writ of habeas corpus. In most – indeed, nearly all – circumstances in which the elements of *Younger* abstention are present, *Younger* counsels that such a delay is an appropriate price to pay for the preservation of comity between the federal government and the states.

In the context of arbitration, however, delayed enforcement destroys the federal statutory right. It would be incongruous if abstention, merely a prudential doctrine, could have such a consequence. In our case, the district court correctly did not abstain because the Delaware regulators' repeated rejection of Olde Discount's FAA preemption claim already ensured that the right to

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respect to the general showing that must be made for an applicant for a preliminary injunction to obtain relief. The appellants' brief is not cast in terms of whether the criteria have been met but instead focuses on the preemption and abstention issues. The brief of the amici, however, does discuss the *Instant Air Freight* criteria. In these circumstances, we will not discuss these criteria in detail but simply will indicate that in view of our conclusions we agree that the district court properly issued the preliminary injunction.

arbitration would be lost, absent a federal court's intervention. Accordingly, despite the rule of *Dayton Christian Schools* that a right to an ultimate state court appeal of agency action suffices to support *Younger* abstention, we hold that where Section 2 of the FAA provides the basis for a federal preemption claim, a district court may not abstain, but must address the merits of the FAA claim.

V. CONCLUSION

In view of the aforesaid and Judge Rosenn's concurring opinion, we will affirm the district court's order of September 16, 1992, and will remand the case to the district court for further proceedings.

ROSENN, *Circuit Judge*, concurring.

Although I agree with the majority's conclusion that the Delaware Securities Commissioner cannot seek rescission as a remedy under 6 Del. C. § 7325(b), I write separately because I arrive at this result by way of contract law rather than the doctrine of preemption.

When Congress enacted the Federal Arbitration Act (FAA), it rejected the traditional hostility of the courts towards arbitration as a remedy in civil disputes and emphasized a strong federal policy in favor of arbitral dispute resolution in cases where a contract exists evidencing a transaction involving commerce. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985). In *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213

(1985), a case similar to the one *sub judice* in that it involved a dispute over a purchase of securities through a broker-dealer, the Court held that the FAA requires district courts to compel arbitration of pendent arbitrable claims, even where the result would be the possible inefficient maintenance of separate proceedings in different forums. The Court observed:

> The preeminent concern of Congress in passing the Act was to enforce private agreements into which parties had entered, and that concern requires that we rigorously enforce agreements to arbitrate . . . at least absent a countervailing policy manifested in another federal statute. By compelling arbitration of state-law claims, a district court successfully protects the contractual rights of the parties and their rights under the Arbitration Act.

Id. at 221.

Significantly, the Court dwelt upon the necessity of enforcing the contractual rights of the parties under the agreement to arbitrate, also observing that "arbitration is not a judicial proceeding." *Id.* at 222 (citing *McDonald v. West Branch*, 466 U.S. 284 (1984)). Thus, the right of a party to enforce an arbitration agreement under the FAA depends not upon the federal doctrine of preemption, but upon the traditional duty of the courts to protect the contractual rights of the parties.

In the present case, Olde's investors' account agreement with the Engelhardts contained a provision stating:

> You agree to submit any and all controversies or claims arising out of this agreement to arbitration to be conducted according to the rules and

> procedures of the New York Stock Exchange, Inc. (NYSE) or the National Association of Securities Dealers, Inc. (NASD) as you may elect. . . .

The agreement further provides, "The parties are waiving their right to seek remedies in court, including the right to a jury trial."

Recently, in *Gilmer v. Interstate/Johnson Lane Corp.*, 111 S. Ct. 1647, 1652 (1991) (citations omitted), the United States Supreme Court stated:

> It is by now clear that statutory claims may be the subject of an arbitration agreement, enforceable pursuant to the FAA. . . . [B]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.

Therefore, Olde and the Engelhardts lawfully bound themselves by the provisions of the agreement to arbitrate claims arising out of their securities transactions.

As noted by the majority, section 7325's remedy of rescission would interfere with the contractually created arbitration agreement in this case. To the extent that the Englehardts attempted an "end run" around the terms of the arbitration agreement by seeking relief in a state administrative proceeding, the district court properly restrained them. Federal courts will not "permit a party to a contract to circumvent an arbitration clause by commencing litigation in a state court." *In re Mercury Constr. Corp.*, 656 F.2d 933, 941 (4th Cir. 1981).

> Finally, the mere involvement of an administrative agency in the enforcement of a statute is not sufficient to preclude arbitration. For

> example, the Securities Exchange Commission is heavily involved in the enforcement of the Exchange Act of 1934 and the Securities Act of 1933, but we have held that claims under both of these statutes may be subject to compulsory arbitration. See McMahon; Rodriguez de Quijas.

Gilmer, 111 S. Ct. at 1653.

My disagreement with the majority stems from my belief that the district court's injunction should not be based on preemption doctrine, but rather the law of contracts. The fundament of Olde's right to settle the Engelhardts' demand for rescission of the securities transaction by arbitration is the arbitration provision contained in the investors' account contract, not the application of the doctrine of preemption.

"[F]ederal pre-emption of state law can occur in three types of situations: where Congress explicitly pre-empts state law, where pre-emption is implied because Congress has occupied the entire field and where pre-emption is implied because there is an actual conflict between federal and state law." *Pokorny v. Ford Motor Co.*, 902 F.2d 1116, 1120 (3d Cir. 1990) (citing *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293 (1988)), *cert. denied*, 498 U.S. 853 (1990).

The FAA "contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration." *Volt Info. Sciences, Inc. v. Stanford University*, 489 U.S. 468, 477 (1989). Nor has Congress occupied the entire field of securities regulation. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117, 135 (1973). The FAA, therefore, preempts a state securities

law only "to the extent that it actually conflicts with federal law." *Volt*, 489 U.S. at 477.

In the case *sub judice*, however, the federal law and the state law do not conflict. The Delaware Statute does not even deal with arbitration, which is the subject of the FAA. Rather, the conflict in this case arises between the state statute, as it relates to rescission, and the parties' contractually created right to arbitrate disputes relating to the securities transaction. The FAA becomes relevant only as it protects the enforcement of the contractual right to arbitrate. Thus, there is no conflict for preemption purposes between a state law and a federal law in this case, but rather a partial remedial conflict between a state law and a contract. *Cf. Osterneck v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 841 F.2d 508, 510 (state statute precluding enforcement of an agreement to arbitrate conflicts with FAA).[1]

Therefore, for the foregoing reasons I would affirm the district court's order enjoining the Delaware Securities Commissioner from pursuing the remedy of rescission of the claims which are subject to the arbitration agreement between Olde and the Engelhardts. I agree with the majority that the district court was not required

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[1] The agreement to arbitrate cannot usurp a state's public interest in enforcing its criminal laws for securities transactions violations or its laws enacted under its police power to protect the public interest generally. "The criminal justice system is not operated primarily for the benefit of victims, but for the benefit of society as a whole." *Kelly v. Robinson*, 479 U.S. 36, 51 (1986). Therefore, the district court was correct not to enjoin the Commissioner from seeking other penal remedies against Olde besides rescission.

to abstain from enjoining the Commissioner's pursuit of rescission.

NYGAARD, *Circuit Judge*, dissenting.

I disagree with the court's conclusion that the Federal Arbitration Act, 9 U.S.C. § 2, preempts 6 Del. Code Ann. § 7325(b) for essentially the same reasons articulated in Judge Rosenn's concurrence. There is no conflict between federal and state law because, as Judge Rosenn notes, the FAA protects the enforcement of the contractual right to arbitrate. Where there has been an allegation of securities fraud, section 7325(b) empowers the Delaware Securities Commissioner to seek rescission at his discretion and in the interest of the public; it says nothing about the validity of the arbitration agreement or the arbitrability of the dispute between Olde Discount and the Engelhardts. Since section 7325(b) does not "require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration," *Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852, 858 (1984), the FAA does not preempt the Delaware statute.

I depart from the reasoning of the concurrence, however, to the extent it concludes that the Engelhardts have the capacity to contract away under Delaware law the Commissioner's authority to institute administrative proceedings and to seek remedies against securities firms doing business in Delaware. The essence of Olde Discount's argument is that there is no distinction between the Engelhardts' civil suit in their own interest to seek a

compensatory award and the Commissioner's administrative actions in the public interest to seek appropriate equitable or punitive measures. This argument is unpersuasive in light of the statutory scheme.

The Delaware Securities Act was enacted "to prevent *the public* from being victimized by unscrupulous or overreaching broker-dealers, investment advisers or agents in the context of selling securities or giving investment advice, as well as to remedy any harm caused by securities law violations." 6 Del. Code Ann. § 7301(b) (emphasis added). The Commissioner administers the statute and serves this policy. Among other things, he may "deny, suspend or revoke any registration if he finds that the order is in the *public interest*"; and he may in his discretion bring an action "to temporarily restrain or to enjoin the acts or practices . . . [as well as seek] such other ancillary relief as is in the public interest. . . . " *Id.* §§ 7316(a), 7320 (emphasis added). In section 7325(b), the Delaware legislature gave the Commissioner the exclusive power to bring administrative proceedings in which he may order the violator "to pay restitution and costs (or to rescind the transaction or transactions and pay costs) if the Commissioner finds it in the *public interest*. . . . " (Emphasis added.) And in section 7323(a), the legislature also gave "the person" who is a victim of securities fraud a nonexclusive, private cause of action in law or equity.

Thus, the Delaware statutory scheme makes clear that the Commissioner is not a surrogate for a plaintiff's attorney, but is a public official who administers the state's blue sky laws "in the public interest" and is endowed with broad enforcement and rulemaking powers. See *Blinder, Robinson & Co. v. Bruton*, 552 A.2d

466, 475 (Del. 1989) ("The Commissioner has discretion to impose any penalty deemed necessary to protect the public interest and further the Act's prophylactic purpose.") Although the Engelhardts' and the Commissioner's suits arise from the same transaction, their respective right or power to sue arises from two separate and distinct statutory provisions.

The arbitration agreement between the Engelhardts and Olde Discount provides that the Engelhardts must "submit any and all controversies or claims arising out of this agreement to arbitration." It also provides, "*The parties* are waiving their right to seek remedies in court, including the right to a jury trial." Under the FAA and this arbitration agreement, there is no doubt that *the Engelhardts* cannot enforce a claim for legal damages or equitable relief under section 7323(a) in a judicial forum. But that is not at issue in this appeal because nothing in the Delaware laws precludes the Engelhardts and Olde Discount from arbitrating.

Here, Olde Discount contends, and the opinion of the court agrees, that the arbitration agreement between it and the Engelhardts precludes *the Commissioner,* acting under the authority of the Delaware legislature, from seeking appropriate remedies and sanctions in the public interest if the Engelhardts have also asked for the "same" relief in their civil complaint. Thus, while this case concerns rescission as a remedy, had the Engelhardts sought injunctive relief as well as money damages in arbitration, there is no reason under the court's opinion why these private parties could not have also contracted away the Commissioner's authority under section 7320 to seek an injunction against Olde Discount.

The Commissioner cannot be bound by an agreement to which he neither agreed nor was a party. One cannot bargain away that which one does not possess; since the power to sue under section 7325(b) and seek appropriate equitable remedies on behalf of the State of Delaware and in the public interest belongs exclusively to the Commissioner, that power cannot be compromised by an agreement between private individuals. Cf. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 103 S.Ct. 927, 939 (1983) (in a multi-party and -claim case, arbitration agreements will be enforced as to those parties and claims subject to the agreement despite piecemeal litigation in the arbitral and judicial forums). Further, the Commissioner's authority to sue and seek remedies exists independently of a plaintiff's right to sue and thus is not derivative of the Engelhardts' rights. See 6 Del. Code Ann. § 7319 ("The Commissioner in his discretion may make such public or private investigations within or outside of this State as he deems necessary. . . . "). See also *Gilmer v. Interstate/Johnson Lane Corp.*, 111 S.Ct. 1647, 1653 (1991) ("In any event, the EEOC's role in combating age discrimination is not dependent on the filing of a charge; the agency may receive information concerning alleged violations of the ADEA 'from any source,' and it has independent authority to investigate age discrimination). Cf. *Isidor Paiewonsky Assocs. v. Sharp Properties, Inc.*, No. 92-7337 (3d Cir., June 24, 1993) (a subtenant who was not a party to an arbitration agreement was bound by the conclusions of the arbitrator because the subtenant and tenant are in privity and thus the subtenant's rights are derivative of the tenant's under traditional landlord-tenant laws).

The argument that section 7325(b) is "preempted" by the FAA or that the Commission is "contractually bound" by the arbitration agreement rests on the unsound assumption that legal damages by the Engelhardts and rescission sought by the Commissioner in the public interest are in essence the same remedies. In *Porter v. Warner Holding Co.*, 328 U.S. 395, 66 S.Ct. 1086 (1946), although regulations provided that a landlord could not be required to make a tender of illegally collected rent if the suit was brought by any person who had commenced an action against the defendant under Section 205(e) of the Emergency Price Control Act of 1942, a federal agency brought suit against the landlord and sought restitution of illegally collected rent under the authority of § 205(a) of the statute. The Supreme Court considered whether a federal district court had jurisdiction, in an enforcement proceeding brought by a federal agency under § 205(a), to order restitution of illegally collected rents. The Court held that it did, and reasoned:

> It is true that § 205(e) authorizes an aggrieved purchaser or tenant to sue for damages on his own behalf. . . . To the extent that damages might properly be awarded by a court of equity in the exercise of its jurisdiction under § 205(a), § 205(e) supersedes that possibility and provides an exclusive remedy relative to damages. *It establishes the sole means whereby individuals may assert their private right to [legal] damages.* . . . Moreover, a court giving relief under § 205(e) acts as a court of law rather than as a court of equity. But with the exception of damages, § 205(e) in no way conflicts with the jurisdiction of equity courts under § 205(a) to issue whatever "other orders" may be necessary

> to vindicate the public interest, to compel compliance with the Act and to prevent and undo inflationary tendencies.
>
> *Restitution, which lies within that equitable jurisdiction, is consistent with and differs greatly from the damages and penalties which may be awarded under § 205(e).* When the Administrator seeks restitution under § 205(a) he does not request the court to award statutory damages to the purchaser or tenant or to pay to such person part of the penalties which go to the United States treasury in a suit by the Administrator under § 205(e). Rather he asks the court to act *in the public interest* by restoring the status quo and ordering the return of that which rightfully belongs to the purchaser or tenant. Such action is within the recognized power and within the highest tradition of a court of equity. Thus it is plainly unaffected by the provisions of § 205(e).

66 S.Ct. at 1090-91 (emphasis added and citations omitted). Thus, legal damages and equitable relief, such as restitution and rescission, are different forms of relief, serving different interests and arising from different powers of the court; and even if an arbitrator decides that the Engelhardts are not entitled to legal damages, that decision neither conflicts with nor precludes a court of equity from granting the remedy of rescission to the Engelhardts in the interest of the public.

The Supreme Court recognized this difference in the arbitration context. In *Gilmer*, the Supreme Court considered whether a claim under the Age Discrimination in Employment Act of 1967 (ADEA) can be subject to arbitration under the FAA. The Court held that ADEA claims

were arbitrable. The Court found unpersuasive the argument that arbitration would undermine the role of the EEOC in enforcing the ADEA. It reasoned, "An individual ADEA claimant subject to an arbitration agreement will still be free to file a charge with the EEOC, even though the claimant is not able to institute a private judicial action." 111 S.Ct. at 1653. Furthermore, "it should be remembered that arbitration agreements will not preclude the *EEOC* from bringing actions seeking class-wide and equitable relief." *Id.* at 1655 (emphasis in original). Equitable relief includes such remedies as injunction and rescission. *Porter,* 66 S.Ct. at 1090-91.

I believe that the opinion of the court unlawfully transfers the authority vested in the Commissioner to private parties. Thus, the boundaries of what the Commissioner, or any other agency with enforcement powers, can or cannot do is not defined by statute, but is limited by the agreements of private individuals. I would hold that since section 7325(b) of the Delaware Securities Act expressly provides that the Commissioner may seek appropriate equitable relief against a violator of the state's securities laws, he is not bound by a private arbitration agreement, nor need he refrain from seeking rescission in the public interest simply because a private party agreed to seek legal damages in an arbitral forum rather than a court of law. I therefore respectfully dissent.

A True Copy:
Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

Filed August 5, 1993

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NO. 92-7557

OLDE DISCOUNT CORPORATION

v.

W. MICHAEL TUPMAN, and as Deputy Attorney General of the State of Delaware; RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware; EUGENE H. ENGELHARDT and CAROL D. ENGELHARDT,

Appellants

Appeal from the United States District Court
for the District of Delaware

(D.C. Civil No. 92-00498)

Argued June 10, 1993

Before: GREENBERG, NYGAARD, and ROSENN,
Circuit Judges

Opinion Filed July 30, 1993

ORDER AMENDING CONCURRING OPINION

It is hereby ordered that the concurring opinion of the slip opinion in the above-entitled case be and is hereby amended as follows:

Page 26, line 1 – change "the majority's" to "Judge Greenberg's";

Page 27, line 24 – change "the majority" to "Judge Greenberg,"

Page 28, line 5 – change "the majority" to "Judge Greenberg";

Page 29, lines 8-9 – change "the majority" to "Judge Greenberg."

BY THE COURT:

/s/ Max Rosenn

Circuit Judge

Dated: August 5, 1993

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NO. 92-7557

OLDE DISCOUNT CORPORATION,

v.

W. MICHAEL TUPMAN, and as Deputy Attorney General of the State of Delaware; RICHARD W. HUBBARD, Securities commissioner of the State of Delaware; EUGENE H. ENGELHARDT AND CAROL D. ENGELHARDT,

W. MICHAEL TUPMAN, individually and as Deputy Attorney General of the State of Delaware; RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware; EUGENE H. ENGELHARDT, CAROL D. ENGELHARDT,

Appellants

On Appeal from the United States District Court
for the District of Delaware
(D. Del. Civil No. 92-0498)

SUR PETITION FOR REHEARING

BEFORE: SLOVITER, *Chief Judge*, and BECKER, STAPLETON, MANSMANN, GREENBERG,

HUTCHINSON, SCIRICA, COWEN, NYGAARD, ALITO, ROTH, LEWIS, AND ROSENN, *Circuit Judges*

The petition for rehearing filed by the appellants W. Michael Tupman, Richard W. Hubbard, Eugene H. Engelhardt, and Carol D. Engelhardt in the above captioned matter having been submitted to the judges who participated in the decision of this court and to all other available circuit judges of the court in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied. Judge Nygaard would grant rehearing by the court in banc for the reasons set forth in his dissenting opinion limited to the preemption issue.

BY THE COURT:

/s/ Morton I. Greenberg
Circuit Judge

DATED: AUG 26, 1993

OLDE DISCOUNT CORPORATION,
Plaintiff,

v.

W. Michael TUPMAN, individually and as Deputy Attorney General of the State of Delaware; Richard W. Hubbard, Securities Commissioner of the State of Delaware, Eugene H. Engelhardt, and Carol D. Engelhardt, Defendants.

Civ. A. No. 92-498-SLR.

United States District Court,
D. Delaware.

Sept. 16, 1992.

James S. Green of Duane, Morris & Heckscher, Wilmington, Del., for plaintiff. Of Counsel: Robert P. Bramnik, Thomas P. Fitzgerald, and Michael I. Behn, of Altheimer & Gray, Chicago, Ill.

W. Michael Tupman, Delaware Dept. of Justice, Wilmington, Del., for defendants W. Michael Tupman and Richard W. Hubbard.

MEMORANDUM OPINION

SUE L. ROBINSON, District Judge.

I. INTRODUCTION

Before the Court is a motion for temporary restraining order, preliminary injunction and other relief filed by plaintiff OLDE Discount Corporation ("OLDE") in order to enjoin defendants from: "(1) pursuing a penal and registration revocation action against the plaintiff which will have the effect of violating plaintiff's federal right to arbitrate. . . . ; (2) pursuing an investigation of OLDE; and

(3) instigating other actions against the plaintiff in Delaware or any other state, pending a hearing and determination on the issuance of a preliminary injunction." (Docket item, "D.I.", 4) Defendants Richard W. Hubbard and W. Michael Tupman (hereinafter "the State defendants")[1], the Securities Commissioner of the State of Delaware and the Deputy Attorney General representing such, respectively, have responded and oral argument was heard on August 27, 1992. Supplemental responses have been received. (D.I. 19, 28)

II. JURISDICTION

Jurisdiction is grounded on plaintiff's claim regarding the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-10, and 28 U.S.C. § 1331.

Venue is proper in this District under 28 U.S.C. § 1391(b) because all defendants reside in this District and because the claims asserted by plaintiff arose in this District.

III. FINDINGS OF FACT

For purposes of this proceeding, the material facts are undisputed:

1. Plaintiff OLDE is a securities firm with its principal place of business located at 751 Griswold Street, Detroit, Michigan 48226. OLDE also has a branch office

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[1] Because the relief sought is directed at the State defendants, defendants Eugene H. and Carol D. Engelhardt have not participated in these proceedings.

located at 208 West Tenth Street, Wilmington, Delaware 19801. (D.I. 12, Ex. 1, ¶ 12)

2. OLDE is and has been registered as a broker-dealer in Delaware since October 6, 1981. Although OLDE is primarily engaged in the discount brokerage business, it does make a market in certain securities, which its agents recommend to customers. In the spring of 1990, one of the stocks was Second National Federal Savings Bank ("SNFS"), a savings and loan association with branches in Pennsylvania, Maryland, Delaware, Virginia, and the District of Columbia. (D.I. 14, Ex. 1, ¶ 15)

3. The Division of Securities of the State of Delaware is a unit within the Department of Justice directed by the Securities Commissioner under the auspices of the Attorney General pursuant to the Delaware Securities Act, 6 Del.C. § 7301 *et seq.*

4. In 1983, defendants Eugene H. and Carol D. Engelhardt opened a joint account with OLDE in Michigan, where they were then residing. When they moved to Delaware in 1986, they transferred their account to OLDE's Wilmington office. In the spring of 1990, their account was assigned to Michael R. Donohoe, the only securities agent employed in OLDE's Wilmington branch. (D.I. 12, Ex. 1, ¶ 22)

5. The Engelhardt's account with OLDE was governed by the terms of an Investors Account Agreement between OLDE and the defendants Engelhardt. The Investors Account Agreement in effect during the period relevant to this proceeding was signed by the defendants Engelhardt on May 25, 1990. According to their Customer

Preference Profile, the defendants Engelhardt had substantial investment experience, having invested in stocks for approximately fifteen years, making an average of three to five trades per year, and trading an average of five to ten thousand shares per transaction. In describing their investment objects, the defendants Engelhardt chose the following adjectives: "aggressive", "growth", "speculation". (D.I. 6, Ex. A)

6. The Investors Account Agreement entered between OLDE and the defendants Engelhardt included a "Predispute Arbitration Clause". The inclusion of the Predispute Arbitration Clause was disclosed in bold face and in large type directly above the defendants' signatures. (D.I. 6, Ex. A)

7. The Predispute Arbitration Clause itself was more specifically spelled out in the terms and conditions portion of the agreement, clauses 17 and 18, in bold type. In relevant part, the Predispute Arbitration Clause provides that the Engelhardts "agree to submit any and all controversies or claims arising out of this agreement to arbitration" according to the procedures of the New York Stock Exchange, Inc. or the National Association of Security Dealers, Inc. (D.I. 6, Ex. A)

8. In May and June 1990, the defendants Engelhardt purchased a total of ten thousand shares of the common stock of SNFS. The total purchase price of the ten thousand shares of SNFS stock was $52,875.00. During the course of the next several months, the market price of SNFS stock declined, causing a parallel decline in the market value of the defendants Engelhardts' SNFS account. (D.I. 1, ¶ 13)

9. In July or August 1990, the defendants Engelhardt telephoned OLDE in Michigan to express their dissatisfaction with their SNFS stock purchase, given the drop in price. The defendants Engelhardt were informed that there was no basis for their complaint, that their SNFS stock purchases were not inappropriate. (D.I. 1, ¶ 15)

10. According to the record, the defendants Engelhardt were advised at that time that they should submit a written complaint to OLDE regarding the circumstances of their claim if they wished to initiate a complaint and/or a fuller review. (D.I. 1, ¶ 15) No written complaint was ever submitted, although the Investors Account Agreement, clause 12, expressly requires investors to object, in writing, within ten days regarding any transactions in their account which are in dispute. (D.I. 1, ¶ 18; D.I. 6, Ex. A)

11. On September 6, 1990, the defendants Engelhardt transferred their SNFS stock out of OLDE. The market value of their SNFS stock at the time of the transfer was approximately $32,500.00, a decline of approximately $20,375.00 from their initial investment. (D.I. 1, ¶ 17)

12. In July 1991, the Division of Securities of the State of Delaware received a complaint from the defendants Engelhardt against OLDE and its agent (by now a former agent), Michael Donohoe, with regard to the purchase of the SNFS stock in May and June of 1990. (D.I. 6, Ex. C; D.I. 12, ¶ 2).

13. By letter dated July 31, 1991, a securities investigator for the Delaware Department of Justice advised

OLDE of the Engelhardts' complaint. The securities investigator related that "[t]he Engelhardts allege that the solicitation to purchase [the SNFS stock] involved omission of material facts (including the risk factor) and high pressure selling techniques. They further allege that Mr. Donohoe marked at least one purchase 'unsolicited'. Finally, they allege that this security was unsuitable for persons in their circumstances." The securities investigator requested that OLDE respond to these allegations by August 26, 1991. (D.I. 6, Ex. C; D.I. 12, ¶ 2) OLDE responded to this and subsequent requests for documents and information. (D.I. 6, Ex. E; D.I. 12, ¶ 2-4)

14. By late May 1992, the Division of Securities had completed its investigation of the Engelhardts' complaint and on June 5, 1992, defendant Tupman sent to OLDE a draft "Notice of Intent to Suspend or Revoke Broker-Dealer Registration", alleging various violations of the Delaware Securities Act, 6 Del.C. §§ 7301 *et seq.* (D.I. 12, ¶ 5) In said Notice, defendant Tupman stated that it was in the public interest that: 1) the broker-dealer registration of OLDE be suspended or revoked; 2) Donohoe be permanently barred from engaging in the securities business in Delaware; 3) OLDE rescind the three sales of SNFS stock to the defendants Engelhardt, and pay the Engelhardts back their purchase price of $52,875.00; and 4) OLDE be fined $10,000.00 for each and every violation of the Act, and that OLDE pay all of the costs incurred by the Division of Securities in connection with the investigation and prosecution of the case. (D.I. 6, Ex. F)

15. By letter dated June 25, 1992, OLDE asserted that the proposed administrative proceeding against OLDE for Donohoe's alleged sales practice abuses was

not warranted. OLDE also offered to settle the Engelhardts' claim concerning their SNFS stock purchases by offering $20,000.00 as compensation for all of the losses which were allegedly caused by Donohoe's conduct. In the alternative, OLDE offered to "pay all filing and form fees for the Engelhardts' claim to be heard and decided by an arbitration panel before the National Association of Securities Dealers, Inc., the New York Stock Exchange, Inc. or the American Arbitration Association." (D.I. 6, Ex. G)

16. By letter dated July 6, 1992, defendant Tupman responded:

> In considering your offer of settlement, I assume that the $20,000.00 figure represents the difference between the price paid by the Engelhardts for their SNFS stock, and the current market value. Given the allegations of unsuitability, I think it much more appropriate for there to be a rescission of the trades, with your firm receiving the stock back and the Engelhardts their purchase price ($52,875.00).
>
> In addition, because of the seriousness of the allegations, and the State's preparedness to prosecute, the public interest would require a substantial contribution to the Investor Protection Fund, as well as written undertakings regarding compliance procedures in your Wilmington branch office.
>
> I do not intend to continue any further written dialogue on the allegations in the draft Notice. I think you have fully set forth your position in your last letter, and I am not amendable to any continued "back and forth" responses. Instead, I suggest you call me later this week (and in no

> event later than noon on Friday, July 10), to discuss the terms of settlement. Otherwise, the Securities Division is prepared to submit the charges to the Commissioner for his approval on July 13.

(D.I. 6, Ex. H)

17. At an August 5, 1992 settlement meeting attended by defendant Tupman and representatives of plaintiff OLDE, defendant Tupman once again rejected OLDE's offer of restitution to the Engelhardts in the amount of $20,375.00 and instead demanded rescission in the amount of $52,875.00, on the grounds that rescission would be more beneficial and fair to the Engelhardts. Defendant Tupman also stated that the Engelhardts refused to arbitrate their civil claims; rather, the Engelhardts had selected the Delaware Securities Commissioner's Office to pursue their claim. (D.I. 6, Ex. I)

18. After the August 5, 1992 meeting with defendant Tupman, OLDE gave written notice of its demand that the Engelhardts arbitrate their civil claim against OLDE concerning their SNFS stock purchases pursuant to their arbitration agreement and the Federal Arbitration Act, 9 U.S.C. §§ 1 *et seq.* The August 5, 1992 notice stated as follows:

> We have been informed by Delaware Deputy Attorney General, W. Michael Tupman, that you have complained to him about the purchase of SNFS stock through OLDE Discount. He further advises that you believe that you have a remedy under the restitution provision set forth in section 7325(b) of the Delaware Code. We disagree.

> You have agreed with OLDE Discount to resolve any and all disputes by arbitration before either the New York Stock Exchange ("NYSE") or the National Association of Security Dealers, Inc. ("NASD"). You further have agreed to make an election within five days of written demand of such election. Please consider this letter our written demand that you make such election.

(D.I. 6, Ex. K)

19. According to his affidavit, defendant Tupman met with the defendants Engelhardt on August 10, 1992 to inform them that plaintiff OLDE had made a settlement offer, to wit, to pay $15,000.00 to the Delaware Investors Protection Fund, in lieu of a fine, and to pay $20,375.00 in full restitution to the Engelhardts for the depreciation in value of their SNFS stock during the entire period of time that the stock was held in their OLDE account. Both defendants Engelhardt "emphatically agreed that they wanted the State to go forward with its case." (D.I. 12, ¶ 11)

20. Also on August 10, 1992, defendant Tupman represented in a letter to OLDE the following:

> [I]t has come to our attention that by letter dated August 5, 1992 . . . , you tried to pressure the Engelhardts into an NASD arbitration, even though we had discussed that legal issue at our meeting the same day, and the State had disagreed with your legal position. I find this further evidence of your bad faith, and therefore terminate settlement negotiations. Your last offer is rejected.
>
> Enclosed are written interrogatories served pursuant to Section 7319 of the Delaware Securities

> Act. An officer, director, or duly authorized agent of OLDE must answer those interrogatories, under oath, and return them to me no later than seven business days after the date of this letter. In addition, with regard to each individual identified in your response to Interrogatory No. 1, we ask that you produce his or her new account form and customer preference profile, and with regard to each transaction identified in your response to Interrogatory No. 2, we ask that you produce the confirmation of purchase. Further, we ask that you produce copies of any letters of complaint, and any response your made, from any Delaware residents with regard to those transactions. You have until the close of business on August 24, 1992 to produce that documents.

(D.I. 6, Ex. M)

21. A Notice of Intent to Suspend or Revoke Broker-Dealer Registration was filed by the Division of Securities on August 17, 1992. Defendant Hubbard, the Securities Commissioner, also signed an order of that same date giving OLDE thirty days to request a hearing on the matter. (D.I. 12, Ex. 1)

22. On August 17, 1992, the Department of Justice issued a press release concerning the Notice of Intent against OLDE. An article reporting the Notice appeared the next day in the News Journal. (D.I. 6, Ex. N)

23. On August 19, 1992, OLDE provided timely responses to defendant Tupman's interrogatories. (D.I. 1, ¶ 39)

24. Plaintiff filed its motion for temporary restraining order, preliminary injunction and other relief on

August 25, 1992, alleging, *inter alia*, that: 1) application and enforcement of § 7325(b) of the Delaware Securities Act, 6 Del.C. § 7325(b), is unconstitutional under Article VI, clause 2 of the United States Constitution (the "Supremacy Clause"); 2) the application of 6 Del.C. § 7325(b), as amended, to the actions of OLDE in 1990 constitutes the imposition of an *ex post facto* penalty in violation of the Due Process Clause of the Fourteenth Amendment of the Constitution of the United States; 3) defendants Tupman and Hubbard have acted under color of state law to deprive the plaintiff of its rights under the Federal Arbitration Act and under the Due Process Clause in violation of 42 U.S.C. § 1983; and 4) defendant Tupman has committed willful acts in the use of process not proper in the regular conduct of these administrative proceedings. (D.I. 1)

IV. CONCLUSIONS OF LAW

The standard for obtaining a temporary restraining order is the same as the standard for a preliminary injunction. Fed. R.Civ.P. 65(b); *Tootsie Roll Industries, Inc. v. Sathers, Inc.*, 666 F.Supp. 655, 658 (D.Del.1987). It is beyond dispute that "the grant of injunctive relief is an 'extraordinary remedy, which should be granted only in limited circumstances.' " *Instant Air Freight Co. v. C.F. Air Freight, Inc.*, 882 F.2d 797, 800 (3d Cir.1989), *citing Frank's GMC Truck Center, Inc. v. General Motors Corp.*, 847 F.2d 100, 102 (3d Cir.1988). Thus, in ruling on a motion for a preliminary injunction, this Court must consider:

> (1) the likelihood that the [movant] will prevail on the merits at final hearing; (2) the extent to which the [movant] is irreparably harmed by the

> conduct complained of; (3) the extent to which the [nonmoving party] will suffer irreparable harm if the preliminary injunction is issued; and (4) the public interest.

Opticians Ass'n of America v. Independent Opticians of America, 920 F.2d 187, 191-92 (3d Cir.1990). As recently reaffirmed by the Third Circuit, an

> injunction should issue only if the [movant] produces evidence sufficient to convince the . . . [C]ourt that all four factors favor preliminary relief.

Merchants & Evans, Inc. v. Roosevelt Bldg. Products, Co., 963 F.2d 628, 632-633 (3d Cir.1992). *See also Instant Air Freight Co. v. C.F. Air Freight, Inc.*, 882 F.2d at 800, *quoting In re Arthur Treachers Franchisee Litigation*, 689 F.2d 1137, 1143 (3d Cir.1982).

A. *Reasonable Probability of Success on the Merits*

1. Pre-emption

Plaintiff's primary argument in support of its request for injunctive relief is that § 7325(b) of the Delaware Securities Act, as amended, 6 Del.C. § 7325(b), is unconstitutional because it directly conflicts with the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-10. The primary substantive provision of the FAA states that

> [a] written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as

> exists at law or in equity for the revocation of any contract.

9 U.S.C. § 2. As explained by the Supreme Court in *Perry v. Thomas*, 482 U.S. 483, 107 S.Ct. 2520, 96 L.Ed 2d 426 (1987),

> "Section 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. The effect of the section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act." *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24, 103 S.Ct. 927, 941, 74 L.Ed.2d 765 (1983). Enacted pursuant to the Commerce Clause, U.S. Const., Art. I, § 8, cl. 3, this body of substantive law is enforceable in both state and federal courts. *Southland Corp. v. Keating*, 465 U.S. 1, 11-12, 104 S.Ct. 852, 858-859, 79 L.Ed.2d 1 (1984). . . . As we stated in *Keating*, "[i]n enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contacting parties agreed to resolve by arbitration." *Id.*, at 10, 104 S.Ct. at 858. "Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." *Id.*, at 16, 104 S.Ct. at 861 (footnote omitted). Section 2, therefore, embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce or is revocable "upon such grounds as exist at law or in equity of the revocation of any contact." 9 U.S.C. § 2. "We see nothing in the

> Act indicating that the broad principle of enforceability is subject to any additional limitations under state law." *Keating, supra,* at 11, 104 S.Ct., 858.

Id. 482, U.S. at 489, 107 S.Ct. at 2525.

In the case of *Perry v. Thomas,* Thomas sued his former employer, Kidder Peabody & Co., for breach of contract, conversion, civil conspiracy to commit conversion, and breach of fiduciary duty, for which he sought compensatory and punitive damages. Thomas refused to submit the dispute to arbitration based on § 229 of the California Labor Code, which authorized Thomas to maintain an action for wages. The Supreme Court, in holding that the Supremacy Clause and § 2 of the FAA pre-empted the state statute, concluded:

> [T]he present appeal addresses the pre-emptive effect of the Federal Arbitration Act, a statute that embodies Congress' intent to provide for the enforcement of arbitration agreements within the full reach of the Commerce Clause. Its general applicability reflects that "[t]he preeminent concern of Congress in passing the Act was to enforce private agreements into which parties had entered. . . . " [*Dean Witter Reynolds Inc. v. Bird,* 470 U.S. 213, 221, 105 S.Ct. 1238, 1242, 84 L.Ed.2d 158 (1985)]. We have accordingly held that these agreements must be "rigorously enforce[d]." *Ibid.; see Shearson/American Express Inc. v. McMahon,* 482 U.S. 220, 226 [107 S.Ct. 2332, 2337, 96 L.Ed.2d 185] . . . (1987); *Mitsubishi Motor Corp. v. Soler Chrysler-Plymouth, Inc.,* 473 U.S. 614, 625-626 [105 S.Ct. 3346, 3353-3354, 87 L.Ed.2d 444] . . . (1985). This clear

> federal policy places § 2 of the Act in unmistakable conflict with California's § 229 requirement that litigants be provided a judicial forum for resolving wage disputes. Therefore, under the Supremacy Clause, the state statute must give way.

482 U.S. at 490, 107 S.Ct. at 2526. *Accord, Securities Industry Asso. v. Connolly,* 883 F.2d 1114 (1st Cir.1989), *cert. denied,* 495 U.S. 956, 110 S.Ct. 2559, 109 L.Ed.2d 742 (1990) (a Massachusetts state regulation which: (1) barred firms from requiring individuals to enter pre-dispute arbitration agreements as a nonnegotiable condition precedent to account relationships; (2) ordered the prohibition brought "conspicuously" to the attention of prospective customers; and (3) demanded full written disclosure of "the legal effect of the pre-dispute arbitration contract or clause", pre-empted by the FAA); *Osterneck v. Merrill Lynch, Pierce, Fenner & Smith,* 841 F.2d 508 (3d Cir.1988) (provision of the Pennsylvania Securities Act, identical to § 410(g) of the Uniform Securities Act and precluding enforcement of an agreement to arbitrate, pre-empted by the FAA).

Not only does the FAA pre-empt state statutes which provide a judicial forum for resolving disputes, "[i]t is by now clear that statutory claims may be the subject of an arbitration agreement, enforceable pursuant to the FAA." *Gilmer v. Interstate/Johnson Lane Corp.,* ___ U.S. ___, ___, 111 S.Ct. 1647, 1652, 114 L.Ed.2d 26 (1991). The issue before the Court in *Gilmer* was whether a claim under the Age Discrimination and Employment Act of 1967 ("ADEA"), could be subjected to compulsory arbitration

pursuant to an arbitration agreement in a securities registration application. The Court, recognizing that "the ADEA is designed not only to address individual grievances, but also to further important social policies", found no

> inherent inconsistency between those [social] policies . . . and enforcing agreements to arbitrate age discrimination claims. It is true that arbitration focuses on specific disputes between the parties involved. The same can be said, however, of judicial resolution of claims. Both of these dispute resolution mechanisms nevertheless also can further broader social purposes. The Sherman Act, the Securities Exchange Act of 1934, RICO, and the Securities Act of 1933 all are designed to advance important public policies, but, as noted above, claims under those statutes are appropriate for arbitration. " [S]o long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function." *Mitsubishi, supra,* 473 U.S., at 637 [105 S.Ct. at 3359]. . . .

___ U.S. at ___, 111 S.Ct. at 1653. Noting the "liberal federal policy favoring arbitration agreements", the Court concluded that Gilmer's ADEA claim was subject to compulsory arbitration.

State defendants argue that the Delaware Securities Act does not directly conflict with the FAA in that no provision specifically precludes plaintiff from pursuing its right to arbitrate. And, indeed, no provision of the Delaware Securities Act even mentions arbitration. There is no question, however, that the regulatory scheme as

currently drafted contemplates administrative proceedings which effectively eliminate a party's right to an arbitral forum.

Under the Delaware Securities Act, 6 Del.C. §§ 7301 *et seq.*, the Securities Commissioner is authorized to suspend or revoke the registration of a broker-dealer or agent, if he determines that such person is subject to one of the disqualifying factors stated in that section and that such action is in the public interest. 6 Del.C.§ 7316(a). Subsection (g) of § 7316 also authorizes the Commissioner, "upon notice and hearing", to fine any broker-dealer, investment advisor or agent in an amount not to exceed $10,000.00 for each and every violation of the chapter, plus the cost of investigation and prosecution.

In addition to the public enforcement authority vested in the Securities Commissioner under § 7316, § 7323 provides as well for private causes of action for rescission brought by injured investors. More specifically, § 7323 provides in relevant part that "[a]ny person who . . . sells . . . a security by means of any untrue statement of a material fact or any omission to state a material fact . . . is liable to the person buying . . . the security . . . , who may sue either at law or in equity to recover the consideration paid for the security. . . . " Subsection (g) of § 7323, modeled after § 410(g) of the Uniform Securities Act, provides:

> (g) Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this chapter or any rule or order hereunder is void.

This subsection is identical to the Pennsylvania statute reviewed by the Third Circuit in *Osterneck*, 841 F.2d at 510, which subsection was found to be pre-empted by the FAA.

Although the Delaware Securities Act provides that any person aggrieved by an order of the Securities Commissioner may obtain a review of the order in the Court of Chancery, the commencement of the judicial review proceedings does not, unless specifically ordered by the Court of Chancery, operate as a stay of the Commissioner's order. 6 Del.C § 7324.

Section 7325(b) of the Delaware Securities Act, the statutory provision primarily at issue, was amended in July 1990 to provide:

> (b) The Commissioner may make, amend and rescind rules, regulations, forms and orders to carry out and define the provisions of this chapter. Such orders may provide for fines, assessment of costs, restitution to investors, conditional or probationary registration, centaur [sic] or reprimand, special reporting requirements, or other provisions which the Commissioner determines to be in the public interest.

Subsequently, in June 1991, subsection (b) was amended once again to provide:

> Any person, whether registered or not, who willfully violates any provision of this chapter, or who aides [sic] and abets any person who willfully violates any provision of this chapter, may be fined in accordance with subsection 7316(g) and order [sic] to pay restitution and costs (*or to rescind the transaction or transactions and pay costs*) if the Commissioner finds it in the

> public interest, any may be criminally prosecuted under § 7322.[2]

Although there apparently is no caselaw directly on point involving state administrative proceedings that impede a party's right to enforce a predispute arbitration agreement, the Securities Commissioner cannot use his authority under 6 Del.C § 7325(b) as both a sword – to enforce under § 7325(b) investors' personal rights to rescission provided under § 7325(a) – and a shield – to insulate the investors from a contracted to arbitral forum by insisting on the primacy of the State's administrative forum – without running afoul of the Supremacy Clause of the Constitution.[3] There is no contention that the arbitration agreement at issue is not enforceable under the FAA. Neither is there a contention at bar that the defendants Engelhardt may not effectively vindicate their statutory cause of action in the arbitral forum.

Given the clear Congressional intent "to provide for the [rigorous] enforcement of arbitration agreements within the full reach of the Commerce Clause", *Perry v. Thomas*,

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[2] Although the State defendants maintain that the Delaware Securities Act is "modeled on the Uniform Securities Act" (D.I. 10 at 21), the Court can find no counterpart in the Uniform Act to § 7325(b) as amended.

[3] The Supremacy Clause provides that:

> This Constitution, and the Law of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. Const., Art. VI, cl. 2.

482 U.S. at 490, 107 S.Ct. at 2526, as given effect by the Supreme Court's interpretation of the FAA, the Court concludes that the FAA serves to withdraw the power of the states not only to require a judicial forum for the resolution of claims, but to require an administrative forum as well. In sum, then, the FAA pre-empts § 7325(b) insofar as that statute allows the Securities Commissioner to order rescission on behalf of individual investors who have signed predispute arbitration agreements.

2. Primary Jurisdiction

The State defendants argue that the FAA does not pre-empt the administrative proceedings at bar by virtue of the doctrines of primary jurisdiction or, alternatively, the exhaustion of administrative remedies. As explained by the United States Supreme Court in *United States v. Western Pacific Railroad Co.*, 352 U.S. 59, 77 S.Ct. 161, 1 L.Ed.2d 126 (1956),

> [t]he doctrine of primary jurisdiction, like the rule requiring exhaustion of administrative remedies, is concerned with promoting proper relationships between the courts and administrative agencies charged with particular regulatory duties. "Exhaustion" applies where a claim is cognizable in the first instance by the administrative agency alone; judicial interference is withheld until the administrative process has run its course. "Primary jurisdiction," on the other hand, applies where a claim is originally cognizable in the courts, and comes into play whenever enforcement of the claim requires the resolution of issues which, under a regulatory scheme, have been placed within the special

> competence of an administrative body; in such a case the judicial process is suspended pending referral of such issues to the administrative body for its views.

Id. at 63-4, 77 S.Ct. at 165.

Applying this lucid explanation to the facts at bar, the Court concludes, first, that the doctrine of primary jurisdiction does not apply. As further illustrated by the Supreme Court in *United States v. Western Pacific Railroad Co.*, "in cases raising issues of fact not within the conventional experience of judges or cases requiring the exercise of administrative discretion, agencies created by Congress for regulating the subject matter should not be passed over." 352 U.S. at 64, 77 S.Ct. at 165. Thus, in that case, the Court concluded that

> where the question is simply one of construction [of a tariff] the courts may pass on it as an issue "solely of law." But where words in a tariff are used in a peculiar or technical sense, and where extrinsic evidence is necessary to determine their meaning or proper application, so that "the enquiry is essentially one of fact and of discretion in technical matters," then the issue of tariff application must first go to the [Interstate Commerce] Commission. The reason is plainly set forth: such a "determination is reached ordinarily upon voluminous and conflicting evidence, for the adequate appreciation of which acquaintance with many intricate facts of transportation is indispensable; and such acquaintance is commonly to be found only in a body of experts."

352 U.S. at 65-66, 77 S.Ct. at 166 (citations omitted). Unlike the interpretation of a tariff, which can involve

complex and technical cost-allocation and accounting problems, enforcement of the Engelhardts' claim does not require the resolution of any issue "placed within the special competence of" the Delaware Securities Commissioner. Indeed, the statutory scheme contemplates that such claims are appropriately resolved in a judicial forum at the investors' discretion; such claims are within the conventional experience of federal judges.

3. Exhaustion of Administrative Remedies

Nor does the doctrine of exhaustion of administrative remedies apply, since the claim at issue, i.e., the Engelhardts' claim for rescission, is not cognizable in the first instance by an administrative agency *alone*. Although by amending § 7325(b) and giving to the Securities Commissioner the authority to order rescission, private litigants (like the defendants Engelhardt) may no longer need to sue in law or in equity for rescission under § 7323(a), the Delaware Securities Act still gives private litigants that option and still specifically provides that "[t]he rights and remedies provided by this chapter are *in addition to* any other rights or remedies that may exist at law or in equity." 6 Del.C. § 7323(h) (emphasis added). Thus, unlike the "comprehensive system of review" established by the National Association of Securities Dealers, Inc. and the Securities and Exchange Commission, *see First Jersey Securities, Inc. v. Bergen*, 605 F.2d 690, 695 (3d Cir.1979), *cert. denied*, 444 U.S. 1074, 100 S.Ct. 1020, 62 L.Ed.2d 756 (1980), the statutory review procedure in question does not establish original and/or exclusive jurisdiction in the administrative proceeding.

Even if the exhaustion doctrine would normally apply, the Third Circuit has "recognized two situations in which the exhaustion requirement will not be adhered to: (1) when the administrative procedure is clearly shown to be inadequate to prevent irreparable injury; or (2) when there is a clear and unambiguous statutory or constitutional violation." *Id.* at 696. Plaintiff asserts that both exceptions apply to the facts at bar by virtue of the preemption of the FAA. The Court agrees.

If the administrative process vis.a.vis the State's rescission action under 6 Del.C. § 7325(b) is allowed to go forward, plaintiff's right to enforce the arbitration agreement entered into between it and the Engelhardts is rendered a nullity, regardless of the substantive result of the administrative proceeding. The loss of the federal substantive right to an arbitral forum is distinguishable from the business losses claimed in *First Jersey Securities, Inc. v. Bergen*, 605 F.2d at 696. Concomitantly, the Commissioner's usurpation of the parties' contractual obligation to arbitrate constitutes a clear and unambiguous violation of the Supremacy Clause as interpreted by the Supreme Court, as discussed above.

4. Abstention

In their supplemental submission (D.I. 19), the State defendants assert that the abstention doctrine of *Younger v. Harris*, 401 U.S. 37, 91 S.Ct. 746, 27 L.Ed.2d 669 (1971), is applicable to the facts at bar. In *Younger v. Harris*, the Supreme Court held that a federal court should not enjoin a pending state criminal proceeding except in the very

unusual situation that an injunction is necessary to prevent great and immediate irreparable injury. The Supreme Court has since applied the *Younger* principles to "state administrative proceedings in which important state interests are vindicated, so long as in the course of those proceedings the federal plaintiff would have a full and fair opportunity to litigate his constitutional claims." *Ohio Civil Rights Commissioner v. Dayton Christian Schools, Inc.*, 477 U.S. 619, 627, 106 S.Ct. 2718, 2722-23, 91 L.Ed.2d 512 (1986). In that case, the administrative proceedings at issue were instituted by the Ohio Civil Rights Commission against a school which had terminated an individual's employment. The employee claimed her termination constituted sex discrimination; the school claimed that any investigation of the school's hiring process or any imposition of sanctions for the school's termination decisions would violate the Religion Clauses of the First Amendment, since the termination was based on the employee's failure to comply with an internal dispute resolution mechanism (the "biblical chain of command"). The Court held that: 1) the elimination of prohibited sex discrimination is a sufficiently important state interest to bring the case within the ambit of the *Younger* doctrine; and 2) the school will receive an adequate opportunity to raise its constitutional claims, if not in the administrative proceeding, then in the state courts' judicial review of the administrative proceeding.

Assuming for purposes of this proceeding that the Securities Commissioner's decision to enforce private, as well as public, interests is "a sufficiently important state interest to bring the case within the ambit of the *Younger* doctrine", nevertheless the question remains whether

plaintiff will receive "a full and fair opportunity to litigate [its] constitutional claim[s]" within the state regulatory scheme. To the extent the claims have relevance given the Court's decision on pre-emption, the state regulatory scheme (which provides for judicial review) affords plaintiff an opportunity to raise its claims based upon the Due Process Clause of the Fourteenth Amendment (*ex post facto* penalties and abuse of process) and 42 U.S.C. § 1983.

Such is not the case with respect to plaintiff's pre-emption claim. Under the auspices of the FAA, plaintiff is guaranteed in the first instance an arbitral forum in which to resolve the Engelhardts' dispute. Any other forum, whether administrative or judicial, will deprive plaintiff of its federal substantive rights under the FAA, indeed, of its opportunity to even raise its constitutional claim under the FAA. Consequently, the *Younger* doctrine is not applicable to plaintiff's pre-emption claim under the FAA.

B. *Irreparable Harm*

As indicated above, the Court has concluded that plaintiff has demonstrated a reasonable probability of success on the merits on its claim that it will be deprived of its constitutionally protected federal right to arbitrate its civil dispute with the defendants Engelhardt should the administrative action for rescission be allowed to proceed. Likewise, the Court concludes that the loss of its federal substantive right to arbitrate, should injunctive relief be denied, constitutes irreparable harm clearly distinguishable from purely economic losses. *See, Alascom,*

Inc. v. ITT North Electric Co., 727 F.2d 1419, 1422 (9th Cir.1984) (if a party "must undergo the expense and delay of a trial before being able to appeal, the advantages of arbitration – speed and economy – are lost forever. We find this consequence 'serious, perhaps irreparable'."); *Opticians Ass'n of America*, 920 F.2d at 195 (irreparable harm must be "of a peculiar nature, so that compensation and money alone cannot atone for it."); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley*, 756 F.2d 1048, 1055 (4th Cir.1985).

C. *Balance of Hardships*

In weighing the possibility of harm to other interested parties from the granting of the injunction and the public interest, *Opticians Ass'n of America*, 920 F.2d at 196, several factors support the Court's conclusion that the form and magnitude of the relief contemplated by the Court are justified under the Third Circuit's preliminary injunction standards. First, the Court is granting preliminary injunction relief only with respect to the State's ability to pursue rescission actions under 6 Del.C. § 7325(b) on behalf of private investors who have entered predispute arbitration agreements enforceable under the FAA. The State is not prevented from enforcing the public's interests through actions authorized under 6 Del.C. § 7316.

Moreover, the defendants Engelhardt are not harmed or disadvantaged in any way by the entry of such an injunction. The defendants Engelhardt are free to exercise their right to have their claim heard and decided in arbitration, consistent with their arbitration agreement

with plaintiff and in accordance with the FAA. The effect of the injunction, therefore, will be to leave the parties in the position that they bargained for, with an arbitral forum as plaintiff has demanded. Finally, issuance of the injunction will advance all the strong federal purposes inherent in the FAA, such as allowing the parties "to avoid the costliness and delays of litigation." *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 510-11, 94 S.Ct. 2449, 2453, 41 L.Ed.2d 270 (1974).

D. *Bond*

The relief requested "raises no risk of monetary harm to the defendants" and, thus, a bond is unwarranted. *Hoxworth v. Blinder, Robinson & Co., Inc.*, 903 F.2d 186, 210 (3d Cir.1990); *Frank's GMC Truck Center, Inc. v. General Motors Corp.*, 847 F.2d at 103.

V. CONCLUSION

For the reasons stated, the Court concludes that plaintiff has satisfied the standard for obtaining a preliminary injunction and, therefore, plaintiff's request for injunctive relief is granted with respect to the Securities Commissioner's authority to pursue a rescission action under 6 Del.C. § 7325(b) on behalf of the defendants Engelhardt, individual investors who are parties to a predispute arbitration agreement with plaintiff, which agreement is enforceable under the Federal Arbitration Act, 9 U.S.C. § 2. The remainder of plaintiff's request for injunctive relief is denied.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

OLDE DISCOUNT CORPORATION, Plaintiff, v. W. MICHAEL TUPMAN, individually and as Deputy Attorney General of the State of Delaware; RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware, EUGENE H. ENGELHARDT, and CAROL D. ENGELHARDT, Defendants.	)	Civil Action No. 92-498-SLR

ORDER

At Wilmington this 16th day of September, 1992, consistent with the Memorandum Opinion issued this same date;

IT IS ORDERED that plaintiff's motion for preliminary injunction (D.I. 4) is granted with respect to the Securities Commissioner's authority to pursue a rescission action under 6 Del. C. §7325(b) on behalf of the defendants Engelhardt, individual investors who are parties to a predispute arbitration agreement with plaintiff, which agreement is enforceable under the Federal Arbitration Act, 9 U.S.C. §2. The remainder of plaintiff's motion for injunctive relief is denied.

/s/ Sue L. Robinson
United States District Judge

BEFORE THE SECURITIES COMMISSIONER
OF THE STATE OF DELAWARE

IN THE MATTER OF:	)	
	)	
OLDE DISCOUNT CORP. and MICHAEL R. DONOHOE,	)	Case No. 91-07-01
	)	
Respondents.	)	

NOTICE OF INTENT TO SUSPEND OR
REVOKE BROKER-DEALER REGISTRATION

1. The Division of Securities ("Division") is a unit within the Department of Justice directed by the Securities Commissioner ("Commissioner") under the auspices of the Attorney General pursuant to the Delaware Securities Act ("Act"), Chapter 73 of Title 6 of the *Delaware Code*.

2. The Commissioner is charged under 6 *Del. C.* Section 7325 with enforcement of provisions of the Act.

3. Section 7316 of the Act authorizes the Commissioner to suspend or revoke the registration of a broker-dealer or agent, or any partner, officer, or director of a broker-dealer, or any person directly or indirectly controlling the broker-dealer or agent, if he determines that such person(s) are subject to one of the disqualifying factors stated in that section and that such action is in the public interest.

4. Section 7316(a)(2) of the Act authorizes the Commissioner to deny or suspend or revoke the registration of a person who has willfully violated or willfully failed to comply with any provision of the Act.

5. Section 7303(2) of the Act provides that it is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly, to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading.

6. Section 7316(a)(7) of the Act authorizes the Commissioner to deny or suspend or revoke the registration of a broker-dealer or agent who has engaged in dishonest or unethical practices within or outside Delaware.

7. Section 7316(a)(10) of the Act authorizes the Commissioner to deny or suspend or revoke the registration of a broker-dealer that has failed reasonably to supervise its agent.

8. Under Section 7316(c), the Commissioner may summarily suspend the registration of a broker-dealer or agent pending final determination of any proceeding under that section of the Act.

9. Section 7316(c) provides that a registrant whose registration has been suspended or may be suspended is entitled to a hearing if a written request is received by the Commissioner. That section also provides that if no hearing is requested, an order of suspension will remain in effect until it is modified or vacated by the Commissioner.

10. Section 7316(g) authorizes the Commissioner to fine any broker-dealer or agent in an amount not to exceed $10,000 for each and every violation of the Act, and to assess the costs of investigation and prosecution.

11. Section 7325(b) of the Act authorizes the Commissioner to rescind a securities transaction or transactions.

Notice of Allegations

The Respondents

12. Respondent OLDE DISCOUNT CORP. ("Olde Discount"), CRD # 5979, is a securities firm with its principal place of business located at 751 Griswold Street, Detroit, Michigan 48226. Olde Discount also has a branch office located at 208 West 10th Street, Wilmington, Delaware 19801. Olde Discount is and has been registered as a broker-dealer in Delaware since October 6, 1981.

13. Respondent MICHAEL R. DONOHOE ("Donohoe"), CRD # 1085905, was, at all times relevant to the allegations in this Notice, a securities agent employed by Olde Discount in its Wilmington branch office. Donohoe's agent registration in Delaware was termed on October 19, 1990, at approximately the same time that he was terminated by Olde Discount for willful misconduct.

14. Donohoe irrevocably appointed the Commissioner as his agent for service of process with respect to any legal proceedings arising out of or in connection with the sale of securities in Delaware, pursuant to Section 7327 of the Act.

The Security

15. Although Olde Discount is primarily engaged in the discount brokerage business, it does make a market in certain securities (known in-house as "Special Venture

Stocks"), which its agents recommend to customers. One of those stocks is Second National Federal Savings Bank ("SNFS"), a savings and loan association with branches in Pennsylvania, Maryland, Delaware, Virginia, and the District of Columbia.

16. On August 9, 1989, the President signed into law the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"). Among other things, FIRREA significantly increased the capital requirements for thrift institutions, and subjected them to stringent reporting and examination requirements by the Office of Thrift Supervision ("OTS"). As emphasized in the SNFS Form 10-K for the fiscal year ended December 31, 1989, "[t]he FIRREA legislation and subsequent regulations will have far-reaching effects on the Savings and Loan Industry," by, for example, placing "new limitations on non-residential lending," and requiring 60% of a thrift's tangible assets to be maintained in "Qualified Thrift Investments."

17. Olde Discount maintains a research file on SNFS, consisting of press releases, newspaper articles and a few research reports, mostly prepared by other firms such as Wheat First Securities. That research file highlighted the recent mergers between several large regional banks, including Sovran Financial and Citizens and Southern, suggesting that such deals "spark heavy buying of bank stocks," and that Crestar (based in Virginia) might be seeking to expand its Mid-Atlantic presence. Most of the articles and reports (other than press releases) in the research file, however, are dated (1988 and 1989).

18. Olde Discount's own research department generated only three research reports on SNFS over the

course of 1989-1990. In a report dated July 21, 1989, it recommended SNFS stock (then selling at 6 3/4 – 7 1/4 per share) as a long-term investment with "steady dividend payments." The next Olde Discount research report, dated July 13, 1990, is a startling contrast: "After further evaluation of regional economic conditions, we believe SNFS may increase its provision for loan losses in Q3 or Q4. . . . This Mid-Atlantic area weakness has the potential to slow SNFS growth in coming months." In addition, the dividend might be reduced. The research report concluded that "at this juncture, SNFS currently has limited upside potential. For this reason, we are changing our rating of the stock to neutral." By this time, the price of the stock had fallen to 4 1/8-4 1/2 per share.

19. In an internal memorandum dated July 31, 1990, Olde Discount's research department painted an even gloomier picture, in light of an external audit being conducted by OTS. "[W]e expect that the OTS will require the company to take some actions that could affect its earnings and dividends in the second half of this year. Thus, we reinforce our neutral position on SNFS until negative market and governmental forces come to pass."

20. In a third research report dated September 27, 1990, Olde Discount changed its recommendation on SNFS stock to "Fully Valued," because OTS had ordered the thrift to increase its loan loss reserves by more than $25 million. Non-performing assets had increased from $30 to $62 million, and the board of directors had voted to suspend the quarterly dividend. The price of the stock had fallen even further, to 3-3 1/4 per share. As of September 30, 1990, the thrift had lost over $16 million during the three previous months alone.

21. By the end of 1990, the situation was worse. As reported in its Form 10-K for the fiscal year ended December 31, 1990, SNFS had failed to meet the core and risk-based capital requirements by $9.9 and $15.8 million, respectively. Because it was not in compliance with regulatory capital requirements, it was required to submit a capital plan to OTS. As noted by the thrift's independent auditors, "[f]ailure to meet the capital requirements and interim capital targets included in the Company's capital plan exposes the Company to regulatory sanctions, including regulatory take-over."

The Delaware Investors

22. Eugene H. Engelhardt and Carol D. Engelhardt are, and have been for all times relevant to this Notice, residents of the State of Delaware. In 1983, the Engelhardts opened a joint account with Olde Discount in Michigan, where they were then residing. When they moved to Delaware in 1986, they transferred their account to Olde Discount's Wilmington office. Their account was assigned to a series of account representatives, and ultimately to Donohoe. At the time, Donahoe [sic] was the only employee in Olde Discount's Wilmington branch; he was both a registered representative and the branch manager.

23. Mr. Engelhardt is 56 years old and a sales manager for the DuPont Company. His wife, who is not employed, is 50. Both of them have college degrees.

24. When Mr. Engelhardt opened an account with Olde Discount in 1983, he chose a discount broker because he did not want investment advice, but rather

preferred to trade a few times a year on securities that he selected. After the account was transferred to Delaware, he did not trade actively, except to purchase certificates of deposit and a few stocks.

25. In the spring of 1990, Mr. Engelhardt purchased stock in Northrop Corporation. When Mrs. Engelhardt stopped by the Olde Discount branch office in Wilmington to drop off the check, Donohoe tried to convince her to buy stock with her own money, as opposed to with her husband. Later, Donohoe called Mr. Engelhardt to recommend that he buy stock in SNFS. When Mr. Engelhardt did not express any interest, Donohoe began to badger him about making this investment. When Mr. Englehardt would telephone to check on his investment portfolio, Donohoe always pushed SNFS stock. Donohoe said that he knew the stock well, because it was a local bank, and Olde Discount's research report gave it a "big buy recommendation." Mr. Engelhardt told Donohoe that he preferred to keep most of his money in CDs.

26. Donohoe, nevertheless, continued to pressure Mr. Engelhardt to buy SNFS stock, telling him that "it was a real good bank" and that he (Donohoe) had "inside knowledge" that it was about to be bought by another bank. Donohoe also said that SNFS paid good dividends, which would pay him more than the interest the Engelhardts were receiving on their CDs.

27. When Mr. Engelhardt told Donohoe that he still was not interested, Donohoe said that in order to make the sale, "I'll even waive the commission." Finally convinced, Mr. Engelhardt decided to buy.

28. On May 15, 1990, the Engelhardts bought 2,000 shares of SNFS stock at 5 1/4 per share for $10,622. On that same day, they also purchased an additional 3,000 shares at 5 3/8 for $16,308. Both confirmation tickets marked the transactions as "unsolicited."

29. In connection with these offers and sales of a security, Donahoe [sic] and Olde Discount (through its agent Donohoe) made untrue statements of material fact, or omitted to state material facts, in violation of 6 *Del C.* Sections 7303(2) and 7316(a)(2).

(1) Among the untrue statements made to the Engelhardts were:

(a) Donohoe had inside knowledge that SNFS was about to be purchased by another bank;

(b) SNFS would pay more in dividends than they were earning in interest on bank instruments; and

(c) Donohoe would waive any commission on the sale.

(2) Among the material facts Donohoe failed to disclose were:

(a) Olde Discount was a market-maker for SNFS stock;

(b) Olde was selling SNFS stock in the capacity as a principal, not as an agent; and

(c) The potential effects of FIRREA and federal thrift regulations on the business and profitability of SNFS.

30. In connection with these offers and sales of a security, Donohoe and Olde Discount engaged in dishonest or unethical business practices in violation of 6 *Del C.* Section 7316(a)(7) by: (1) failing to do a proper due diligence check with regard to this security; and (2) noting on the confirmation statements that the sales were "unsolicited," when in fact they were solicited by Donohoe. Olde Discount's own Compliance Manual provides that "[a]ll solicited trades must be noted as 'solicited' when the order is entered into the computer system. It is a violation of Section 204 of the Uniform Securities Act for a registered representative to mark a trade as 'unsolicited' when in fact the transaction was solicited."

31. In addition, Olde Discount failed reasonably to supervise its agent, Donohoe, in connection with the offers and sales of that security, in violation of 6 *Del. C.* Sections 7316(a)(10).

32. After the initial sales, Donohoe continued to pursue the Engelhardts to purchase more SNFS shares. He said that a "round lot" of 10,000 shares would be easier to sell. He also recommended buying more of the stock because he claimed the thrift was "strong, "in good shape," would continue to pay good dividends." Again, he suggested that he knew of "things going on," alluding to a potential acquisition of SNFS by another bank, which would make this "a really good deal."

33. On Donohoe's recommendation, the Engelhardts bought another 5,000 shares of Second National stock on June 6, 1990 at 5 1/4 per share for $26,250. Again the confirmation ticket marked the transaction as "unsolicited."

34. In connection with this offer and sale of a security, Donohoe and Olde Discount (through its agent Donohoe) made untrue statements of material fact, or omitted to state material facts, in violation of 6 *Del C.* Sections 7303(2) and 7316(a)(2).

(1) Among the untrue statements made to the Engelhardts were:

(a) Donohoe had inside knowledge that SNFS was about to be purchased by another bank;

(b) SNFS would continue to pay good dividends; and

(c) The thrift was "strong" and in "good shape."

(2) Among the material facts Donohoe failed to disclose were:

(a) Olde Discount was a market-maker for SNFS stock;

(b) Olde was selling SNFS stock in the capacity as a principal, not as an agent; and

(c) The potential effects of FIRREA and federal thrift regulations on the business and profitability of SNFS.

35. In connection with this offer and sale of a security, Donohoe and Olde Discount engaged in dishonest or unethical business practices in violation of 6 *Del C.* Section 7316(a)(7) by: (1) failing to do a proper due diligence check with regard to this security; and (2) noting on the confirmation statement that the sale was "unsolicited," when in fact it was solicited by Donohoe.

36. In addition, Olde Discount failed reasonably to supervise its agent, Donohoe, in connection with the offers and sales of that security, in violation of 6 *Del. C.* Sections 7316(a)(10) and 7316(a)(2).

37. Despite the public information that came out about SNFS shortly after the Engelhardts purchased their stock – as reflected in Olde Discount's own research files and internal memoranda – neither Donohoe nor anyone else from Olde Discount made any effort to keep the Engelhardts abreast of their investment so as to allow them to make an informed decision whether to hold on or cut their losses by selling. Indeed, even though Mr. Engelhardt called Donohoe in July 1990 because he was concerned about the drop in the price of his stock, Donohoe told [sic] encouraged him to hold on to it because it would turn around. Nor did Donohoe ever call the Engelhardts to apprise them of new information pertinent to their investment. This was in violation of Olde Discount's own Compliance Manual, which provides: "If a client owns a Special Ventures Security, the broker should contact the client when new information on that Special Ventures Security appears on the computer terminal or when information is received in the overnight mail."

38. Mr. Engelhardt also complained to Olde Discount's home office in Michigan to one of the firm's vice presidents in July 1990. She said that she would look into the matter, but when Mr. Engelardt [sic] had not heard anything in some time, he called her back. She said that she had talked with Donohoe, and concluded that he had done nothing wrong.

39. The securities transactions described above occurred in the State of Delaware and involved investors who are Delaware residents.

40. Respondents have collectively committed at least fifteen separate violations of the Act.

41. It is in the public interest that the broker-dealer registration of Olde Discount be suspended or revoked.

42. It is in the public interest that Donohoe be permanently barred from engaging in the securities business in Delaware.

43. It is in the public interest that the respondents rescind the two sales of SNFS stock to the Englehardts, and pay them back their purchase price of $52,875.

44. It is also in the public interest that the respondents be fined $1,000 for each and every violation of the Act, and that they pay all of the costs incurred by the Division in connection with the investigation and prosecution of this case.

Dated: August 17, 1992

/s/ W. Michael Tupman
W. MICHAEL TUPMAN
Deputy Attorney General

BEFORE THE SECURITIES COMMISSIONER
OF THE STATE OF DELAWARE

IN THE MATTER OF:	)	
	)	
OLDE DISCOUNT CORP. and MICHAEL R. DONAHOE,	)	Case No. 91-07-01
	)	
Respondents.	)	
	)	

ORDER

Upon the authority of 6 *Del. C.* Section 7316(c), it is hereby ordered that a hearing shall be held on the foregoing charges if written requests by the respondents are received in my office within thirty (30) days of the date of this Order. If no request for a hearing is received from any particular respondent, the foregoing allegations shall be deemed to have been admitted by that individual or entity, and I will issue a final order of suspension, revocation, rescission, fine, and/or costs against that individual or entity.

/s/ Richard W. Hubbard
RICHARD W. HUBBARD
Securities Commissioner

Dated: August 17, 1992

ADDITIONAL PROVISIONS OF THE DELAWARE SECURITIES ACT, IN PERTINENT PART

6 Del. Code Ann. § 7301:

Sec. 7301. Short title – Purpose. (a) This chapter shall be known and may be cited as the "Delaware Securities Act."

(b) The purpose of the Delaware Securities Act is to prevent the public from being victimized by unscrupulous or overreaching broker-dealers, investment advisers or agents in the context of selling securities or giving investment advice, as well as to remedy any harm caused by securities law violations. This prophylactic and remedial purpose shall be deemed of paramount importance in the interpretation of the provisions of this Act and particularly in any judicial review of sanctions or penalties imposed by the Securities Commissioner and of motions or requests by persons affected to stay such sanctions or penalties.

6 Del. Code Ann. § 7316(a) & (g):

Sec. 7316. Denial, revocation, suspension, cancellation and withdrawal of registration of broker-dealers, investment advisers and agents. (a) The Commissioner may by order deny, suspend, or revoke any registration if he finds that the order is in the public interest and that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, director, or any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser:

(1) Has filed an application for registration which as of its effective date, or as of any date after filing in the case of an order denying effectiveness, was incomplete in any material respect or contained any statement which was, in light of the circumstances under which it was made, false or misleading with respect to any material fact; or

(2) Has wilfully violated or wilfully failed to comply with any provision of this chapter; or

(3) Has been convicted of a felony, infamous crime, or other crime involving moral turpitude; or

(4) Is permanently or temporarily enjoined by any court of competent jurisdiction from engaging in or continuing any conduct or practice involving any aspect of the securities business; or

(5) Is the subject of an order of the Commissioner denying, suspending, revoking registration as a broker-dealer, investment adviser or agent; or

(6) Is the subject of an order entered within the past 10 years by the securities administrator of any other State or by the Securities and Exchange Commission either ordering the person to cease and desist from engaging in or continuing any conduct or practice involving any aspect of the securities business, or suspending, denying or revoking registration as a broker-dealer, investment adviser or agent, or the substantial equivalent of those terms as defined in this chapter; or is suspended or expelled from a national securities exchange or national securities association registered under the Securities

Exchange Act of 1934 either by action of a national securities exchange or national securities association, the effect of which action has not been stayed by administrative or judicial order; or is the subject of a United States Post Office fraud order; or

(7) Has engaged in dishonest or unethical practices within or outside this State; or

(8) Is insolvent, either in the sense that his liabilities exceed his assets or in the sense that he cannot meet his obligations as they mature; or

(9) Is not qualified on the basis of such factors as training, experience, and knowledge of the securities business, except as otherwise provided in subsection (b); or

(10) Has failed reasonably to supervise his agents if he is a broker-dealer or investment adviser, or an agent with supervisory responsibilities, and the Commissioner may infer such failure from an agent's violations; or

(11) Has failed to pay the proper filing fee, but the Commissioner shall vacate any denial or suspension order when the deficiency has been corrected; or

(12) Has violated or failed to comply with any lawful order issued by the Commissioner; or

(13) Has within the past 10 years been a partner, officer, director, controlling person, or any person occupying a similar status or performing similar functions, in a broker-dealer or investment adviser whose registration in this State or any State, or with the Securities and Exchange Commission, has been revoked for disciplinary reasons, or whose membership in a national securities

exchange or national securities association has been terminated for disciplinary reasons.

(g) The Commissioner shall, upon notice and hearing as further defined by subsection (c) of this section, have the right to fine any broker-dealer, investment adviser or agent in an amount not to exceed $10,000 for each and every violation of this chapter, plus the costs of investigation and prosecution.

6 Del. Code Ann. § 7320:

Sec. 7320. Injunctions. Whenever it appears to the Commissioner that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this chapter or any rule or order hereunder, he may in his discretion bring an action in the Court of Chancery to temporarily restrain or to enjoin the acts or practices and to enforce compliance with this chapter or any rule or order hereunder. The Commissioner may also seek, and the Court of Chancery shall upon proper showing grant, such other ancillary relief as is in the public interest including the appointment of a receiver, temporary receiver, conservator, obtaining of an accounting, orders of rescission, orders of restitution, or other relief as may be appropriate in the public interest. The Court shall not require the Commissioner to post a bond.

6 Del. Code Ann. § 7322:

Sec. 7322. Criminal penalties. (a) Fraud of $50,000 or more; Class E Felony. Any person who wilfully violates

section 7303 of this chapter, thereby causing any investor or investors to lose $50,000 or more, shall upon conviction be fined not more than $200,000 or imprisoned not more than 5 years at Level V incarceration, or both, per violation.

(b) Fraud of $10,000 or more; Class F Felony. Any person who wilfully violates section 7303 of this chapter, thereby causing any investor or investors to lose $10,000 or more, though less than $50,000, shall upon conviction be fined not more than $100,000 or imprisoned not more than 3 years at Level V incarceration, or both, per violation.

(c) Other Violations; Class G Felony. Any person who wilfully violates any provision of this chapter, and whose offense is not covered by subsections (a) or (b) above, shall upon conviction be fined not more than $100,000 or imprisoned not more than 2 years at Level V incarceration, or both, per violation.

(d) No indictment or information may be returned under this chapter more than 5 years after the alleged violation. The Superior Court shall have exclusive jurisdiction of any criminal violations of this chapter.

(e) In addition to the penalties stated above, restitution to any investor or investors may be ordered. Nothing in this chapter limits the power of the State to punish any person for any conduct which otherwise constitutes a crime by statute.

6 Del. Code Ann. § 7323:

Sec. 7323. Civil liabilities. (a) Any person who:

(1) Offers or sells a security in violation of § 7313 or § 7304 or any order under § 7308 of this title, or

(2) Offers, sells or purchases a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statement made, in the light of the circumstances under which they are made, not misleading (the buyer or seller not knowing of the untruth or omission), and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known of the untruth or omission, is liable to the person buying or selling the security from or to him, who may sue either at law or in equity to recover the consideration paid for the security, together with the interest at the legal rate from the date of payment costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security, or for damages if he no longer owns the security.

(b) Every person who directly or indirectly controls a seller or buyer liable under subsection (a), every partner, officer, or director of such a seller or buyer, every person occupying a similar status or performing similar functions, every employee of such seller or buyer who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale or purchase are also liable jointly and severally with and to the same extent as the seller or buyer, unless the non-seller or non-buyer who is so liable sustains the burden of proof that he did not know, and in exercise of reasonable care could not

have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.

(c) Any tender specified in this section may be made at any time before entry of judgment.

(d) Every cause of action under this chapter survives the death of any person who might have been a plaintiff or defendant.

(e) No person may sue under this section more than 3 years after the contract of sale. No person may sue under this section if the buyer received a written offer, before suit and at a time when he owned the security, or if a seller received a written offer before suit, to refund the consideration paid together with interest at the legal rate from the date of payment, less the amount of any income received on the security, and he failed to accept the offer within [30 days] of its receipt, or if the buyer received such an offer before suit and at a time when he did not own the security, unless he rejected the offer in writing within [30 days] of its receipt.[1]

(f) No person who has made or engaged in the performance of any contract in violation of any provision of this chapter or any rule or order hereunder, or who has acquired any purported right under any such contract

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[1] 68 Del. Laws, c. 181, purported to delete "30 days" in (e), but made no substitution instead of that term. This was due to a typographical error in the bill that was unfortunately adopted by the Code Revisers. The term "30 days" is probably still valid.

with knowledge of the facts by reason of which its making or performance was in violation may base any suit on the contract.

(g) Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this chapter or any rule or order hereunder is void.

(h) The rights and remedies provided by this chapter are in addition to any other rights or remedies that may exist at law or in equity.

NO. 93-

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OCTOBER TERM, 1993

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Respondent,

BRIEF FOR NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC. AND NATIONAL CONSUMERS LEAGUE AS *AMICI CURIAE* SUPPORTING PETITIONER, RICHARD W. HUBBARD

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Amici Curiae

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MOTION FOR LEAVE TO FILE BRIEF, AMICI CURIAE

The North American Securities Administrators Association, Inc. and the National Consumers League make this motion for leave to file the attached Brief, Amici Curiae, pursuant to Rule 37.2 of this Court. Written permission of the petitioner, Richard W. Hubbard was sought and received. See attached letter. Written permission of the respondent, Olde Discount Corporation, was sought and refused. See attached letter. Therefore,

leave of the Court is sought to file the Amici curiae Brief supporting the Petitioner and in favor of granting the Writ of Certiorari.

INTEREST OF THE AMICI CURIAE

NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.

The North American Securities Administrators Association is an association of state and provincial securities administrators in the United States, including the District of Columbia and Puerto Rico, Canada and Mexico. NASAA serves as the forum where its members work together to protect investors at the grassroots level and to promote fair and open capital markets. NASAA speaks as the collective voice for its members in forwarding those interests.

The interest of NASAA in the present case is two fold. First, the Securities Commissioner of the State of Delaware is a member of NASAA and has asked NASAA to join as an ***amicus curiae***. Second, the decision of this Court will have a direct impact upon most of the

other members of NASAA. Four other member states, Arizona, the District of Columbia, Indiana, and Virginia have statutory authority similar to that granted by Section 7325(b) of the Delaware Securities Act to grant administrative restitution or rescission. Twenty-six other members have statutory provisions specifically allowing the securities agency to seek restitution or rescission in a court action for injunction. Three additional jurisdictions, Arkansas, Michigan, and Tennessee grant their securities agency specific authority to seek disgorgement, a remedy having a similar effect to restitution or rescission. Most of the remaining United States members have adopted Section 408 of the Uniform Securities Act, 1 Blue Sky L. Rep. (CCH) ¶5548 (1957), which allows the agency to seek an injunction and ancillary relief. This Court and the state courts have held that such ancillary relief shall include rescission,

restitution, and disgorgement.[1] State securities regulators of those states maintain an independent interest in, and rely upon, such authority as part of the panoply of remedies available to them.

The members' interest in such authority is firmly based on their statutory mandate to protect the public interest. Although investors in a particular transaction or case are obviously the focal point of their regulatory authority, the "public interest" should not be so narrowly interpreted as to exclude the regulators' efforts to promote investor protection generally as well as fair and open capital markets. In their effort to fulfill their mandate to protect the public interest, NASAA members protect the public-at-large, including investors and others participating in the securities marketplace. If, as a

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[1] See e.g, Mitchell v. Robert De Mario Jewelry, Inc., 361 U.S. 288 (1960); Porter v. Warner Holding Co., 328 U.S. 395 (1946); State ex rel. Day v. Southwest Mineral Energy, Inc., 617 P.2d 1334 (Okla. 1980). See also 12A J. Long, Blue Sky Law §9.05[6] (1992).

result of the regulators' efforts to protect the public interest of investor protection generally, some individual investors are incidentally benefitted personally from that action, the Court should not interpret such regulatory authority as being captive to those individual investors. In order to fulfill their mandate, state and federal regulatory agencies of all types must be provided with the appropriate regulatory tools. If the opinions below are affirmed, a principal regulatory tool currently used by securities agencies as well as a substantial number of other regulatory agencies to deter violations will no longer be available. By narrowing the available range of sanctions, the courts below will have forced regulators to abandon a balanced approach to determining an appropriate deterrent in a particular case. Instead, lacking flexibility, they will be forced to impose more draconian penalties having much broader consequences for those regulated. For example, a securities agency, not able to seek

restitution or rescission, may be left with little choice but to revoke or suspend the license of a major broker dealer in response to a violation by one of its branch offices or registered representatives. Without the power of rescission or restitution, the remaining alternative sanctions available to the agency, other than suspension or revocation, may be deemed ineffective to deter future offenses. Such revocation or suspension sanction often is not as an appropriate sanction as restitution or rescission because it may have broad negative consequences for other investors and employees associated with that broker dealer in the state and beyond.[2]

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[2] Under Section 204(a)(2)(E) of the Uniform Securities Act, 1 Blue Sky L. Rep. (CCH) §5524 (1956), suspension or revocation of a broker-dealer or agent's registration by one state is grounds for revocation or suspension of the broker-dealer or agent's license in all other states where it or he is registered.

NATIONAL CONSUMERS LEAGUE

The National Consumers League (the "NCL") is a national membership-based consumer advocacy organization, founded in 1899, committed to a broad-based effort to protect individuals in the marketplace, employment sector, and health care fields. The National Consumers League is also active in consumer protection areas such as investment and securities fraud abatement. The National Consumers League created both the Alliance Against Fraud in Telemarketing and the National Fraud Information Center to work with consumers on educational and advocacy projects designed to warn the public about fraudulent and deceptive securities agencies which regulate investment offerings to their citizens and are a major force in protecting citizens against fraudulent and deceptive activities.

NCL believes that state regulation is the most efficient and effective way for a citizen to maintain access to information and seek protection in securities and investment deal-

ings. NCL has an interest in the present case because it recognizes that state securities regulators must have effective regulatory tools to promote effective regulation.

SUMMARY OF ARGUMENT

Rule 10 outlines those reasons to be considered by the Court when deciding whether exercise its discretion and grant certiorari. NASAA and the NCL believe that the present case meet most of those enumerated criteria.

Most importantly, this case presents a situation where the Third Circuit has decided an important question of federal law which "has not been, but should be, settled by, this Court." Rule 10.1(c). This is not a typical case where two private litigants are seeking the solution to a private dispute. This case involves an issue which strikes at the very foundations of our nation--the division of political power between the federal government and the states. The trial court has enjoined a state official from performing his duty under a state law, adopted under the police

power of the State, which he is sworn to enforce. The Third Circuit has upheld such injunction on the basis of the Supremacy Clause and the claimed preemption of the state law by the Federal Arbitration Act. Traditionally, this Court has held that in the case of the preemption of a state law that the delicate balance between the sovereign rights of the state and the supremacy of the Federal government entitles the state to have the preemption issued reviewed and decided by this Court as the highest Federal court.

Further, if allowed to stand, the decision of the Third Circuit will have far a reaching impact upon the securities, consumer protection, and other regulatory statutes of many states. A wide variety of public welfare and regulatory statutes in most of the states provide that either the regulating agency or the courts may grant rescission, restitution or disgorgement as part of a state enforcement action. The ability of these agencies to continue to seek these traditional remedies in

those cases involving investors with arbitration clauses would be in serious question under the ruling of the Third Circuit in the present case.

The impact of this decision is not limited to state enforcement efforts. It may heavily impact the enforcement activities of federal regulatory agencies and self-regulatory organizations such as the Securities and Exchange Commission, the Federal Trade Commission, the Commodity Futures Trading Commission, the National Association of Securities Dealers, and the major stock exchanges. A self-regulatory organization, such as the NASD, may be put in the awkward situation of being able to award rescission in their arbitration cases, but not in their disciplinary hearings. All these agencies routinely seek rescission, restitution, or disgorgement in their administrative and court enforcement actions. Again, the ability to continue their practices is placed in serious jeopardy by the decision of the Third Circuit.

Finally, the decision below could have a substantial impact upon the ability of the state courts to award restitution as part of a criminal sentence. Such awards are becoming increasingly popular as an alternative to incarceration for white collar offenses.

Second, NASAA and the NCL submit that the conclusion of the Third Circuit concerning the preemption of the Delaware Securities Act by the Federal Arbitration Act runs contrary to prior holdings of this Court. Rule 10.1(c).

In ***Gilmer v. Interstate/Johnson Lane Corp.***, ___U.S.___, 111 S. Ct. 1647 (1991), this Court held that claims under the Age Discrimination and Employment Act ("ADEA") could be made subject to a compulsory arbitration clause. As in the case of the securities acts, ADEA provides for enforcement through both private suit and public enforcement actions by the Equal Employment Opportunity Commission ("EEOC"). The Court specifically concluded that a private arbitra-

tion clause would not prevent the EEOC, or the courts at its request, from granting relief.

Further, in ***Schneiderwind v. ANR Pipeline Co.***, 485 U.S. 293, 299 (1988), this Court held that preemption is a matter of congressional intent. Subsequently, in ***Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University***, 489 U.S. 468, 477 (1989), the Court held that there was no specific preemption provision in the Federal Arbitration Act nor was there any congressional intent to fully occupy the arbitration field. Finally, in ***California v. ARC America Corp.***, 490 U.S. 93, 101 (1989), the Court indicated that a state act enacted under the historic police powers of the States will not be preempted by a Federal Act unless that is a clear and manifest intent by Congress to do so.

The Third Circuit decision in the present case to preempt the Delaware Securities Act clearly runs contrary to these principles.

Third, the fragmented nature of the decision below suggests that this Court should exercise its power of supervision over the lower federal courts. Rule 10.1(a). As noted above, this case involves a far reaching issue of national importance involving states rights. Yet, a divided Third Circuit did nothing more than affirm the decision of the trial court. One judge dissented, voting to reverse the trial court and find no pre-emption. The two judges constituting the majority could not agree upon the appropriate rationale for their conclusion. One judge based his affirmance on preemption, the other on a contract theory. As a result, there is no majority decision as to why the Delaware provision should be preempted. Thus, while the case stands as precedent that state securities administrators may not seek re-stitution in administrative actions, Delaware and the other states are not provided with a satisfactory rationale for such conclusion. This Court should exercise its supervisory

authority to correct such an unsatisfactory state of the law.

ARGUMENT

I. THE PRESENT CASE INVOLVES A MAJOR PUBLIC POLICY ISSUE AFFECTING NOT ONLY DELAWARE, BUT ALSO THE ENFORCEMENT AND CRIMINAL JUSTICE PROGRAMS OF MANY OTHER STATES AND FEDERAL AGENCIES.

NASAA and the NCL believe that the Third Circuit made a grievous error in affirming the grant of a preliminary injunction against the Delaware Securities Commissioner. This injunction prohibited the Commissioner from exercising the power granted to him under Section 7325(b) of the Delaware Securities Act, 6 Del C. § 7325(b), to issue an order of rescission against Olde Discount Corporation and in favor of the Engelhardt's as a penalty for violation of Section 7316 of the Delaware Securities Act, 6 Delaware C. §7316. It is likely that, if allowed to stand, that the decision below will be interpreted in subsequent decisions to prohibit the Securities Commissioner from issuing orders of restitution and disgorgement as well.

The decision of the Third Circuit and its logical extensions will have a far reaching impact. They will affect the enforcement efforts not only on state securities regulatory agencies, but also those of all state and federal enforcement agencies in the consumer protection area. Further, they may impact many criminal justice programs which incorporate restitution as one of the available criminal penalties.

If allowed to stand, the lower court decisions in the present case will have a direct impact upon most of the other members of NASAA. As will be seed below, four other states have statutory authority similar to that granted by Section 7325(b) of the Delaware Securities Act to grant administrative restitution or rescission. Twenty-six other members have statutory provisions specifically allowing the securities agency to seek restitution or rescission in a court action for injunction. Three additional jurisdictions grant their securities agency

specific authority to seek disgorgement, a remedy having a similar effect to restitution or rescission.

Many other consumer protection and public welfare statutes contain similar authority to seek either agency or court-ordered rescission, restitution, or disgorgement.[3] The decision below could also be used as a basis for restricting the availability of these remedies under these statutes as well.

Nor is the potential impact of the Third Circuit's decision limited to the state level. Many federal agencies such as the Securities and Exchange Commission[4] and self-regulatory agencies such as the National Association of

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[3] See e.g., Wis. Stat. Ann. § 426.100; Uniform Consumer Credit Code § 6.113, 2 Consumer Credit Guide ¶ 5363 (1969). The Uniform Consumer Credit Code has been adopted in eight states and territories. Colorado, Guam, Indiana, Oklahoma, South Carolina, Utah, Wisconsin and Wyoming.

[4] See e.g., SEC v. Washington County Utility Dist., 676 F.2d 218 (6th Cir. 1982).

Securities Dealers[5] have traditionally used rescission, restitution, and disgorgement to deny violators of the fruits of their violation.[6]

The Third Circuit's decision could also have a major impact in the criminal law area as well.[7] Increasingly, the states are allowing their courts to order restitution as part of the sentence which may be imposed or

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[5] See e.g., Hateley v. SEC, 1993 U.S.App. LEXIS 26840 (9th Cir. Oct. 18, 1993).

[6] While admittedly the issue here would not be preemption by the FAA, the same rationale could be used to argue that Congress intended the FAA to be superior to the recovery provisions of the regulatory statutes.

[7] Both the state and federal securities acts make it a felony to violate the provisions of the act. See e.g., Section 24 of the Securities Act of 1933, 15 U.S.C. § 77x (1990); Section 7322 of the Delaware Act, 6 Del. C. § 7322; Section 409 of the Uniform Securities Act, Uniform Securities Act § 409, 1 Blue Sky L. Rep. (CCH) ¶ 5549 (1957). Section 409(b) of the Uniform Act specifically authorizes the securities agency to refer criminal cases to the local prosecuting attorney or Attorney General. This provision was not included in the Delaware Act because the Securities Commissioner is part of the Department of Justice.

as a condition of parol.[8] If the opinions below are allowed to stand, the State could not seek, nor could the court grant, such relief where the defendant had entered into an arbitration agreement with his victims.

Clearly, Congress did not intend to impact these areas of civil and criminal enforcement when it passed the FAA in the mid-1920's. The sole purpose of the passage of the FAA was to reverse the centuries old prejudice of the courts against arbitration. ***Southland Corp. v. Keating***, 465 U.S. 1, 10, (1984); ***Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.***, 460 U.S. 1, 24 (1963). This rather obscure 65-year old statute should not be re-interpreted in a way never intended by Congress. It is not super statute which trumps all other federal or state statutes which might impinge

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[8] See e.g., People v. Richards, 17 Cal. 3d 614, 13 Cal. Rptr. 537, 552 P.2d 97 (1976). This concept has been applied in the securities area. People v. Baumgart, 218 Cal. App.3d 1207, 267 Cal. Rptr. 534 (1990); State v. Stephan, 35 Wn. App. 889, 671 P.2d 780 (1983).

to a limited degree upon its full application. Certainly, there was no Congressional intent, when adopting the FAA, to prohibit state administrative agencies from seeking the full range of possible equitable relief in their civil enforcement cases under consumer protection and public welfare statutes properly adopted under the state's police power. Nor did Congress intend to restrict the federal administrative agencies[9] or the ability of the

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[9] The same issue exists at the federal level in a slightly different context. Section 20 of the Securities Act of 1933, 15 U.S.C. §77t (1990) and Section 21(d)(1) of the Exchange Act of 1934, 15 U.S.C. §78u (1990), allow the SEC to seek civil injunctions for violation of these federal acts. These Sections have uniformly been held to allow the SEC to seek general equitable relief in the form of disgorgement or restitution. See e.g., SEC v. Blavin, 760 F.2d 706 (6th Cir. 1985); SEC v. Shapiro, 494 F.2d 1301 (2d Cir. 1974); SEC v. Penn Cent. Co., 425 F. Supp. 593 (E.D.Pa. 1976). The issue at the federal level is not preemption since both the securities acts and the FAA are acts of Congress, but rather which should be given superior effect. It will no doubt come as a surprise to the SEC that it has lost the right to seek disgorgement or restitution in any enforcement case where the target of the action has an arbitration clause with his victims. Yet, this is the logical conclusion of the decisions below.

states to fashion appropriate relief in criminal cases.

A. IMPACT ON DELAWARE.

The two major fault with Third Circuit's decision are: (1) that the court failed to recognize the nature of the action by the Delaware Securities Commissioner against Olde; and, (2) that they failed to understand the purpose for giving the Administrator the right of restitution or rescission under Section 7325(b). The action against Olde is not a reparations action similar to that authorized by Congress under the Commodity Futures Trading Act.[10] The Commissioner, in the present case, is not being substituted for a court or an arbitrator as the hearing body in a private adversarial proceeding leading to

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[10] Congress specifically set up such an administrative private recovery system in Section 18 of the Act, 7 U.S.C. § 18 (1990). This system allows the Commission to hear investor complaints and to award reparations to injured investors upon establishment of a violation of the Commodity Act.

potential recovery by a private party.[11] Instead the action against Olde is an administrative enforcement action under Section 7316.

The Commissioner, through his staff, is seeking, on behalf of the State, to enforce the Securities Act. In doing so, he is acting in the same way that a prosecuting attorney would seek to enforce the Act through a criminal prosecution. In both cases, the State, not the Engelhardts, is the real party in interest. The Engelhardts are merely the victims and the complaining witnesses. An order granting restitution or rescission under Section 7325(b) is merely one of the alterna-

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[11] The trial court apparently thought such was the case when it said:

> [T]he Court concludes that the [Federal Arbitration Act] serves to withdraw the power of the states not only to require a judicial forum for the resolution of claims, but to require an administrative forum as well. Slip Op. at 7.

This would be a proper conclusion to reach as to a state administrative private reparations similar to that run by the CFTC. Southland Corp. v. Keating, 465 U.S. 1 (1984).

tive sanctions which may be assessed for violation of Section 7316(a)(1)-(13).

Judge Nygaard recognized this distinction when he stated in his dissent below:

> Thus, the Delaware statutory scheme makes clear that the Commissioner is not a surrogate for the plaintiff's attorney, but is a public official who administers the state's blue sky laws "in the public interest" and is endowed with broad enforcement and rule-making powers. See Blinder, Robinson & Co. v. Bruton, 552 A.2d 466, 475 (Del. 1989) ("The Commissioner has the discretion to impose any penalty deemed necessary to protect the public interest and further the Act's prophylactic purpose.") Although the Engelhardt's and the Commissioner's suits arise from the same transaction, their respective right or power to sue arises from two separate and distinct statutory provisions.

1 F.3d at 217 (Nygaard, J., dissenting).

This Court has held that such orders of restitution or rescission serve the public policy function of making sure that a violator does not profit from his violation. ***Porter v. Warner Holding Co.***, 328 U.S. 395 (1946). In this way, it serves much the same function as the equitable remedy of disgorgement. See e.g., ***SEC v. Blavin***, 760 F.2d 706 (6th Cir.

1985); ***SEC v. Shapiro***, 494 F.2d 1301 (2d Cir. 1974); ***SEC v. Penn Cent. Co.***, 425 F. Supp. 593 (E.D.Pa. 1976).

This Court has also recognized the public nature of restitution orders in criminal cases in ***Kelly v. Robinson***, 479 U.S. 36 (1986). In deciding that an obligation arising as a result of a state criminal restitution order could not be discharged in bankruptcy, the Court said:

> The criminal justice system is not operated primarily for the benefit of victims, but for the benefit of society as a whole. Thus, it is concerned not only with punishing the offender, but also with rehabilitating him. Although restitution does resemble a judgment "for the benefit of" the victim, the context in which it is imposed undermines that conclusion. The victim has no control over the amount of restitution awarded or over the decision to award restitution. Moreover, the decision to impose restitution generally does not turn on the victim's injury, but on the penal goals of the State and the situation of the defendant.

Id. at 52. See also ***SEC v. Bilzerian***, 814 F.Supp. 116 (D.D.C. 1993).

These same goals are present in the grant of authority under Section 7325(b) for the Delaware Commissioner to order restitution or rescission. In both cases, the purpose for allowing restitution or rescission is the public policy interest of the State. In both instances, the victim is merely an incidental beneficiary of State policy and has no control over the process by which the restitution or rescission is granted. Clearly, it was not in the public interest to enjoin the Securities Commissioner from carrying out his duty to enforce the Delaware Securities Act and the public policy expressed therein.

B. IMPACT ON OTHER STATE SECURITIES AGENCIES.

Some thirty-three other state securities agencies have specific provisions in their securities acts allowing either administrative or court ordered restitution, rescission, or disgorgement. Four of these states, Arizona, the District of Columbia, Indiana, and Vir-

ginia[12] have statutes similar to Section 7325(b) of the Delaware Securities Act, allowing administrative restitution or rescission. Twenty-six other states have statutory provisions specifically allowing the securities agency to seek restitution or rescission in a court action for injunction.[13] Three further jurisdictions, Arkansas, Michigan, and Tennessee grant their securities agency specific authority to seek disgorgement.[14]

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[12] Ariz. Rev. Stat. §44-2032(1) and Reg. of Ariz. Corp. Comm'n Rule 14-4-308; Dist. Col. Code §2-2614; Ind. Code §23-2-1-17.1(a); and Code of Va. §13.1-521(c).

[13] These states are: Alabama, California, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Maine, Massachusetts, Mississippi, New Mexico, New York, North Carolina, Oklahoma, Oregon Pennsylvania, Rhode Island, South Dakota, Texas, Utah, Vermont, Washington, and Wisconsin.

[14] See Ark. Code §23-42-209(b) (1987); Mich. Compl. Laws §451.808(a) (1979); Tenn. Code Ann. §348-2-119 (b).

Most of the remaining states have adopted Section 408 of the Uniform Securities Act.[15] This section allows the agency to seek an injunction and ancillary relief. Both this court and the state courts have held that such ancillary relief includes rescission, restitution and disgorgement.[16] For example, this Court in ***Porter v. Warner Holding Co.***, 328 U.S. 395, 402 (1946), said:

> [U]nder §205(a) [of the Rent Control Act which was worded similarly to Section 408 of the Uniform Securities Act], [the equity courts have the power] to issue whatever "other order" may be necessary to vindicate the public interest, [and] to compel compliance with the Act...
> Restitution, which lies within that equitable jurisdiction, is consistent with and differs greatly from the damages and penalties which may be awarded under §205(e). [Citation omitted.] When the Administrator

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[15] 1 Blue Sky L. Rep (CCH) ¶5548 (1957). This Act has been adopted in 41 state or territorial jurisdictions. See 1 Blue Sky L. Rep. (CCH) ¶5500 (1992).

[16] See e.g, Mitchell v. Robert De Mario Jewelry, Inc., 361 U.S. 288 (1960); Porter v. Warner Holding Co., 328 U.S. 395 (1946); State ex rel. Day v. Southwest Mineral Energy, Inc., 617 P.2d 1334 (Okla. 1980). See also 12A J. Long, Blue Sky Law §9.05[6] (1992).

> seeks restitution under Section 205(a), he does not request the court to award statutory damages to the purchaser or tenant or to pay to such person part of the penalties which go to the United States Treasury in a suit by the Administrator under Section 205(e). Rather he asks the court to act in the public interest by restoring the status quo and order in the return of that which rightfully belongs to the purchaser or tenant. Such action is within the recognized power and within the highest tradition of a court of equity.

The decisions below, if not reversed, may set a precedent which would prevent these state agencies from exercising their statutory right to order or seek rescission, restitution or disgorgement.

C. IMPACT ON OTHER STATE AGENCIES.

The effect of the Third Circuit's decision is not limited to the area of the state securities administrators. Many state consumer protection and public welfare contain similar provisions. For example, the consumer finance statute in Florida,[17] the Franchise

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[17] FSA §516.23.

Disclosure Act in Illinois[18], and the Insurance Codes of Alabama and Arizona,[19] all allow the administrator or commissioner to grant administrative restitution under certain conditions. The California Government[20] and Insurance Code[21] as well as the Florida Retail Installment Sales Act[22] allow administrative agencies to seek court ordered restitution. A number of Uniform and Model state acts also have similar provisions. For example, the Model State Commodity Code adopted by eighteen states[23] allows the administrator to seek dis-

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[18] Ill. Comp. Stat. Ann., Ch. 815, §705/22.

[19] Ala. Code 1975, §27-5A-11; A.R.S. §20-486.10.

[20] West's Ann. Cal. Gov. Code, §13975.1

[21] West's Cal. Ann. Ins. Code, §789.

[22] F.S.A. 520.994.

[23] Arizona, California, Colorado, Georgia, Idaho, Indiana, Iowa, Maine, Missouri, Montana, Nebraska, Nevada, New Mexico, North Carolina, North Dakota, Oregon, Utah, and Washington. NASAA Rep. (CCH) ¶264 (1992).

gorgement[24]. The Uniform Consumer Credit Code, adopted in eight[25] states, also provides for restitution in a number of situations. The ability of the state agencies to continue to act under these provisions will be greatly impaired if the opinions below are allowed to stand.

Further, it is becoming increasingly common for state attorney generals, either individually or collectively, to bring Parens Patriae suits on behalf of consumers or residents of the state.[26] Again, the Third Circuit's decision would bring into question whether the attorney generals can bring such suits on behalf of those consumers or resi-

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[24] Model State Commodity Code, §2.02 (b)(3), NASAA Rep. (CCH) ¶4422 (1992).

[25] These states and territories are: Colorado, Guam, Indiana, Oklahoma, South Carolina, Utah, Wisconsin, and Wyoming.

[26] See e.g, Heller v. Doe, ___U.S. ___, 113 S.Ct. 2637 (1993); Foucha v. Louisana, ___U.S.___, 112 S. Ct. 1780 (1992)(mentally handicapped) and Kansas-Missouri v. Utilicorp United Inc., 497 U.S.199 (1990); California v. American Stores Co., 492 U.S. 1301 (1989)(anti-trust).

dents who had signed arbitration clauses with the defendants.[27]

D. IMPACT ON FEDERAL AGENCIES.

Section 20 of the Securities Act of 1933, 15 U.S.C. § 77t (1990) and Section 21(d)(1) of the Exchange Act of 1934, 15 U.S.C. § 78u (1990), allow the SEC to seek civil injunctions for violation of these federal acts. These Sections have uniformly been held to allow the SEC to seek general equitable relief in the form of disgorgement or restitution. ***SEC v. Blavin***, 760 F.2d 706 (6th Cir. 1985); ***SEC v. Shapiro***, 494 F.2d 1301 (2d Cir. 1974); ***SEC v. Penn Cent. Co.***, 425 F. Supp. 593 (E.D. Pa. 1976). Nor is the SEC alone in possessing

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[27] The same issue in raised in connection with class actions brought by members of the class whom have not signed arbitration agreements. May they represent members of the class who have?

this power. Both the FTC[28] and the CFTC[29] have similar authority.

The issue at the federal level will not be preemption since the various regulatory statutes and the FAA are acts of Congress. Yet, the reasoning of the Third Circuit could be used to argue that the proarbitration policy of the FAA was intended to be superior to the enforcement policy expressed in the individual regulatory statutes. As a result, it could be concluded that the FAA trumps the restitution authority of the various federal agencies.

E. IMPACT ON CRIMINAL JUSTICE.

The decisions below may also have a major impact in the criminal law area as well. The state and federal securities acts, as do most public welfare statutes, make it a felony to

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[28]Charnita, Inc. v. F.T.C., 479 F.2d 684 (3d Cir. 1973). See also 15 U.S.C. §1607 (1988).

[29]CFTC v. America Metals Exch. Corp., 991 F.2d 71 (3d Cir. 1993); CFTC v. Co Petro Mkts. Group, Inc., 680 F.2d 573 (9th Cir. 1982). 7 U.S.C. §13 (1988).

violate the provisions of the Act. See e.g., Section 7322 of the Delaware Act, 6 Del. C. §7322. As noted above, there is an increasing tendency for the states to allow orders of restitution as part of a criminal sentence, conviction or as a condition of probation.[30] This concept has been applied in the securities area. ***People v. Baumgart***, 218 Cal.App.3d 1207, 267 Cal. Rptr. 534 (1990); ***State v. Stephan***, 35 Wn. App. 889, 671 P.2d 780 (1983). If the opinion below remains unmodified, it could be argued that the State would be prohibited from seeking, or the court granting, rescissional or restitutional relief as part of a criminal conviction where the defendant had entered into an arbitration agreement with his victims.

F. THE FAA HAS NO APPLICATION.

As Judge Nygaard, in his dissenting opinion noted, the FAA should have no appli-

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[30] See Kelly v. Robinson, 479 U.S.36 (1986). See also Ark. C.A. §§8-4-103, 8-6-204, and 8-7-204 (pollution violations).

cation to the present case. 1 F.3d at 217. This Court has long recognized that the FAA only applies where both parties have agreed to arbitrate. ***Atkinson v. Sinclair Refining Co.***, 370 U.S. 238 (1962); ***United Steelworkers of America v. Warrior & Gulf Nav. Co.***, 363 U.S. 574 (1960). It is clear in the present case that the Commissioner has not so agreed. 1 F.3d at 218 (Nygaard, J., dissenting). As pointed out above, the trial court and the Third Circuit failed to separate the interests of the State in enforcing its Securities Act from the Engelhardt's interest in securing recovery under that Act.[31] Those interests are separate and distinct. As Judge Nygaard concluded, the State should not be bound by the Engelhardt's agreement to arbitrate when it is seeking to enforce its own independent interests even though such enforcement may

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[31]Judge Nygaard, in his dissenting opinion, properly makes this distinction and it is the basis for his dissent. 1 F.3d at 217-218.

incidentally benefit the Engelhardts.[32] The State, having not agreed to arbitrate, is not subject to the FAA.

In summary, it should be clear from the above discussion that the preemption issue involved in the present case is one of primary national importance. It involves the accommodation of two major public policies--that of the right of the individual to enter into an enforceable arbitration agreement and that of the State to prevent violation of its statutes properly enacted under the police power for the welfare and benefit of its citizens. This Court should exercise its discretion under Rule 10.1(c) to hear and decide the case.

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[32] He said:

> The Commissioner cannot be bound by an agreement to which he neither agreed nor was a party. One cannot bargain away that which one does not possess.

Id. at 218.

II. THE THIRD CIRCUIT'S DECISION THAT THE COMMISSIONER'S POWER TO ORDER RESTITUTION OR RESCISSION UNDER SECTION 7325(b) WAS PREEMPTED BY THE FEDERAL ARBITRATION ACT IS CONTRARY TO THE DECISIONS OF THIS COURT.

NASAA and the NCL submit that the Third Circuit's decision that the Federal Arbitration Act preempted the power of the Delaware Commissioner to seek rescission under Section 7325(b) of the Delaware Securities Act is contrary to the prior holdings of this Court. As a result, the Court should grant certiorari to review the matter under Rule 10.1(c).

The Court recently stated in ***Schneiderwind v. ANR Pipeline Co.***, 485 U.S. 293, 299 (1988):

> A pre-emption question requires an examination of congressional intent. [Citation omitted.] Of course, Congress explicitly may define the extent to which its enactments preempt state law. See e.g, Shaw v. Delta Air Lines Inc., 463 U.S.85, 95-96 (1983). In absence of explicit statutory language, however, Congress implicitly may indicate an intent to occupy a given field to the exclusion of state law. Such purpose properly may be inferred where the pervasiveness of the federal regulation precludes supplementation by the States, where the federal interest in the field is sufficiently dominant, or where "the object sought to be obtained by the

federal law and the character of obligations imposed by it...reveal the same purpose." Rice v. Santa Fe Elevator Corp., 331 U.S. 218,230 (1947). Finally, even where Congress has not entirely displaced state regulation in a particular field, state law is pre-empted when it actually conflicts with federal law. Such a conflict will be found "'when it is impossible to comply with both state and federal law, Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-143 (1963), or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress, Hines v. Davidowitz, 312 U.S. 52, 67 (1941).'" California Coastal Comm'n v. Granite Rock Co., 107 S.Ct. 1419, 1425 (1987), quoting Silkwood v. Kerr-McGee Corp., 464 U.S. 238, 248 (1984). (Citations modified).[33]

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[33] As Judge Widner pointed out in his dissent in **Saturn Distribution Corp. v. Williams**, 905 F.2d 719, 728 (4th Cir. 1989) (Widner, J. dissenting), these categories of preemption are not of equal weight but rather represent "a sliding scale in which a finding of preemption becomes more difficult as the tension between state and federal enactments becomes more obscure." He goes on to point out that the category of preemption resulting from the frustration of federal policy rests at the bottom of this sliding scale because this theory is more an exercise of policy choices by a court than strict statutory construction. Moreover, this independent judgment has to be made without aid of congressional guidance because of both express or implied congressional silence on the matter, **Abbot v. American Cyanamid Co.**, 844 F.2d 1108, 1113 (4th Cir.), **cert. denied**, 488

The following year, the Court, in ***Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University***, 489 U.S. 468, 477 (1989), specifically addressed the preemption issue in the context of the FAA. It said:

> The FAA contains no express preemption provision, nor does it reflect a congressional intent to occupy the entire field of arbitration.

Thus, it is clear that the first two grounds for preemption do not exist under the FAA in the present case. Section 7325(b) of the Delaware Securities Act does not in any way prohibit arbitration clauses. It merely provides that the commissioner may order restitution as one of the penalties which may be assessed against a broker-dealer for violation of the Delaware Securities Act. Further, Olde could comply with both the federal act and the state statute.

U.S. 908 (1988) and in the face of a presumption against preemption in the case of such silence. **Id.** at 1112.

Therefore, the Third Circuit's conclusion on preemption has to be based upon a holding that Section 7325(b) stands "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."

Yet, as Professor Tribe states, summarizing the holding of this Court:

> [S]tate laws that merely push against the grain of "general expressions of national policy" in federal statutes will not, for that reason alone, be deemed to be preempted.

L. Tribe, American Constitutional Law §6-26 at 488 (1988).

The decision below is clearly in conflict with the holding of this Court. This Court said in ***Louisiana Public Service Comm'n v. FCC***, 476 U.S. 355,370 (1986), federal and state law "should be read so as not to create a conflict" if at all possible. Such a position is based upon two primary premises: (1) that the diffusion of power will further democracy and (2) that a finding of no preemption may be overridden by Congress whereas a finding of preemption can not. ***Agency Rent-***

A-Car, Inc. v. Connolly, 686 F.2d 1029 (1st Cir. 1982). Further, the presumption in favor of validity and against preemption is strongest in a case where the state is seeking to exercise an acknowledgedly valid police power. As this Court said in ***California v. ARC America Corp.***, 490 U.S. 93, 101 (1989):

> [W]e start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.

quoting ***Rice v. Santa Fe Elevator Corp.***, 331 U.S. 218, 230 (1947).

The present case involves a well recognized exercise of that police power. This Court has long recognized that the state has the right to regulate broker-dealers under the police power. ***Travelers Health Assoc. v. Virginia***, 339 U.S. 643 (1950) and ***Merrick v. N.W. Halsey & Co.***, 242 U.S. 568 (1917). As developed above, there is a strong State interest in giving the Commissioner the authority to issue orders of restitution or

rescission. The victims, in this case, the Engelhardts, are merely the incidental beneficiaries of the vindication of that State interest.

This Court, in ***Gilmer v. Interstate/ Johnson Lane Corp.***, ___U.S.___, 111 S. Ct. 1647 (1991), held that private claims under the Age Discrimination and Employment Act ("ADEA") could be made subject to a compulsory arbitration clause. As in the case of the securities acts, ADEA provides for enforcement through both private suit and public enforcement actions by the Equal Employment Opportunity Commission ("EEOC"). The Court specifically addressed the issue of whether a private arbitration clause would prevent the EEOC, or the courts at its request, from granting relief. The Court said:

> We also are unpersuaded by the argument that arbitration will undermine the role of the EEOC in enforcing the ADEA. An individual ADEA claimant subject to an arbitration agreement will still be free to file a charge with the EEOC, even though the claimant is not able to institute a private judicial

> action. ___U.S. at ___, 111 S. Ct. at 1653.

This is exactly what the Engelhardts have done in the present case.

The Court then went on to address the ability of the EEOC to act on that complaint. It said:

> Finally, it should be remembered that arbitration agreements will not preclude the EEOC from bringing actions seeking class-wide and equitable relief.

Id. at ___, 111 S. Ct. at 1655. [Emphasis added.]

Thus, this Court has made clear that private arbitration clauses are not to be considered to impinge upon the right of an administrative agency to enforce the statutes that they are charged with administering. These agencies are free to exercise their statutory powers to grant administrative relief and to seek all authorized judicial relief, including equitable relief such as rescission, restitution or disgorgement as outlined by this Court in ***Porter v. Warner***

Holding Co., 328 U.S. 395, 402 (1946), quoted above. As a result, the conclusion of pre-emption by the Third Circuit simply does not square with this Court's decision *Rice*, *ARC America*, *Gilmore*, and the other cases cited above.

III. THE RENDERING OF THREE SEPARATE OPINIONS BY THE THIRD CIRCUIT LEAVES AN UNSATISFACTORY SITUATION AS TO THE STATE OF THE LAW IN THIS CASE AND THE COURT SHOULD EXERCISE ITS SUPERVISORY JURISDICTION TO SETTLE THE UNCERTAINTY.

The Third Circuit opinion in the present case is the worst possible decision in order to resolve, clearly and finally, the pre-emption issue. Instead of issuing a single opinion, three separate opinions were entered, each taking a different position. One judge, Judge Greenberg, voted to affirm the trial court on a theory of preemption. Judge Nygaard specifically dissents on this issue, holding as NASAA and the NCL suggest that there should be no preemption. Finally, Judge Rosenn concurs in the affirmance of the trial court, but on a contract theory. Thus, there

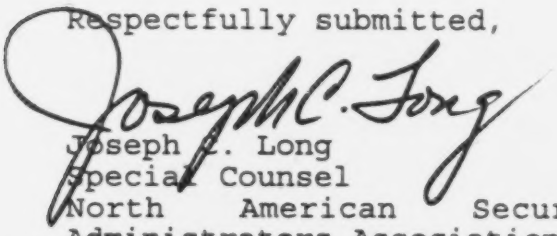
is no majority decision as to the preemption issue, merely an affirmance of trial court decision. This leaves a clearly unsatisfactory state of the law. The Delaware Commissioner is enjoined from enforcing his statute, but he does not know whether such conclusion is based upon preemption or contract or both. Similarly, other states and their enforcement agencies are at a loss as to how the decision should be applied to their acts. Since the Greenberg opinion appears as the opinion of the court, it will no doubt be cited by counsel and other courts as the majority opinion, when in fact it is not.

The State of Delaware, as well as the other states whose acts may be affected, are entitled to a resolution of this issue and that resolution should come from this Court. Therefore, the Court should exercise its supervisory authority over the lower federal courts to grant certiorari as provided in Rule 10.1(a).

CONCLUSION

For the above stated reasons, NASAA urges the Court to grant certiorari in the present case.

Respectfully submitted,



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(3)

No. 93-680

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In The

Supreme Court of the United States

October Term, 1993

RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware,

Petitioner,

vs.

OLDE DISCOUNT CORPORATION,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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COUNTERSTATEMENT OF QUESTION PRESENTED

The two questions presented by petitioner are inappropriate under the criteria outlined in Rule 10 of the Supreme Court Rules, since they are not implicated by the record below. The record below does support the following question:

Whether state officials, acting under color of state law, may circumvent and interfere with a valid arbitration agreement by asserting and interpositioning the civil claim of the party bound to arbitrate in the guise of a state administrative proceeding.[1]

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1. In accordance with Supreme Court Rule 29.1, respondent OLDE Discount Corporation ("OLDE") states that it is a Michigan corporation with its principal place of business in Detroit, Michigan. OLDE Discount is a wholly-owned subsidiary of OLDE Financial Corporation. OLDE Financial Corporation has debentures outstanding which were previously issued in a public offering.

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No. 93-680

In the

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Petitioner,

vs.

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Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

RESPONDENT'S BRIEF IN OPPOSITION

COUNTERSTATEMENT OF THE CASE

In accordance with Supreme Court Rule 15.1, a Counterstatement of the Case is necessary because the petition recites as "fact" many assertions which are either not part of the record or were otherwise rejected below. More importantly, the

petition fails to provide the Court with the underlying facts which grounded the decisions below. The "Questions Presented" recited in the petition are not the issues which would be before the Court if a writ of certiorari were issued, since they are derived from misstatements and omissions of fact and assertions of "fact" which improperly posture the record below. For these reasons alone, the petition is devoid of any merit for review and should be denied.[2]

Contrary to the impression left by the petition, the underlying facts and circumstances which gave rise to this action do not relate to the traditional or even *bona fide* exercise of a state's regulatory powers to enforce its securities laws. The record below evidences the improper use of prosecutorial threats and extortion by public officials for the sole purpose of advancing purely private interests and resolving private disputes, in the guise of investor protection. A more appropriate statement of the background, facts and proceedings below demonstrates the absence of any issue warranting review by the Court.

OLDE Discount Corporation ("OLDE") is a securities broker-dealer registered with the U. S. Securities and Exchange Commission and with numerous states, including Delaware. Eugene H. and Carol D. Engelhardt (the "Engelhardts") are

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2. For example, petitioner's Statement of the Case relies heavily upon the allegations contained in the Notice of Intent to Suspend or Revoke Broker-Dealer Registration ("Notice"). (App. 76-88). However, the allegations of wrongdoing contained in the Notice have *never* been findings in the record below. The Notice is significant solely in that petitioner, in the context of an administrative proceeding, sought private relief in the form of rescission on behalf of two investors, Eugene H. and Carol D. Engelhardt, appellants below, who had entered into an arbitration agreement with respondent OLDE. The court below attached particular significance to the fact that the Notice "proposed individual relief for the Engelhardts only." (App. 6). [References to "App." are to the Appendix accompanying the Petition for Writ of Certiorari.]

Delaware residents who opened a joint brokerage account with OLDE. In connection with the opening and maintenance of their account, the Engelhardts signed a brokerage account agreement with OLDE which contains an arbitration clause requiring the Engelhardts to submit to arbitration, any and all controversies or claims arising out of their brokerage transactions or account with OLDE.

In May and June, 1990, the Engelhardts purchased shares of the common stock of Second National Federal Savings Bank ("SNFS") in their OLDE account. Months after that purchase, the market price of SNFS declined. The Engelhardts became dissatisfied with their SNFS purchases, but never submitted a written complaint to OLDE, even though their account agreement expressly required them to do so in writing, within ten days of any disputed transaction. (App. 52). Subsequently, in September 1990, when the market value of their SNFS stock had declined approximately $20,375 from their initial investment, the Engelhardts transferred their SNFS stock out of their OLDE account. (App. 52).

Over a year after their purchase of SNFS stock, in July 1991, the Engelhardts complained to the Division of Securities of the Delaware Department of Justice about their SNFS stock purchases. (App. 5). The Division, primarily through W. Michael Tupman ("Tupman"), a Delaware Deputy Attorney General responsible for securities law enforcement, investigated the Engelhardts' complaint. (App. 5). After completion of a nearly year long investigation of OLDE, in May 1992, Tupman sent OLDE a draft "Notice of Intent to Suspend or Revoke Broker-Dealer Registration" ("Notice"). (App. 53). The Notice read like a private civil complaint of the Engelhardts. It alleged violations of the Delaware Securities Act solely in connection with the Engelhardts' SNFS stock purchases; and sought private relief solely on behalf of the Engelhardts, including rescission of their purchases of SNFS

stock. (App. 6).[3] If filed, the Notice would trigger an administrative proceeding which, among other things, would resolve the Engelhardts' complaint against OLDE. Resolution of that dispute in the state's administrative proceeding would, in turn, circumvent OLDE's right to have the dispute resolved in arbitration, in accordance with the Engelhardts' arbitration agreement.

In an effort to settle the threatened (but not yet initiated) administrative proceeding which had been crafted solely on behalf of the Engelhardts, counsel for OLDE engaged in settlement communications with Tupman. Ultimately, OLDE offered to make a $15,000 contribution to the Delaware Investor Protection Fund (which was to "reimburse" the State for its expenses in the investigation) to resolve any putative public interest in the threatened administrative proceeding, and offered to pay $20,375 to the Engelhardts to settle their private complaint. The offer of payment to the Engelhardts represented the difference between the total price paid for their SNFS stock and the market value of the stock in September, 1990 when they transferred their stock out of OLDE. (App. 6-7). Alternatively, OLDE offered to pay all the filing and forum fees for the Engelhardts' claim to be heard and decided in arbitration. (App.54).

Significantly, it is undisputed that Tupman agreed to accept OLDE's $15,000 contribution to the Investor Protection Fund to resolve and settle any state putative public interest. (App. 7,54). Tupman refused, however, on behalf of the Engelhardts, OLDE's settlement offer and instead demanded complete rescission of the Engelhardts' SNFS stock purchases, as contemplated by the threatened administrative proceeding. (App. 7, 54). Throughout

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3. In July, 1990, the Delaware Securities Act was amended to authorize the Securities Commissioner to award private civil relief to Delaware residents in state administrative proceedings.

the communications with Tupman, OLDE consistently maintained that Tupman and petitioner Richard W. Hubbard ("Hubbard"), the Delaware Securities Commissioner could not properly pursue in any administrative proceeding, private rescissionary relief on behalf of the Engelhardts, since OLDE had a contractual right to arbitrate the Engelhardts' complaint. (App. 7).

The culmination of the settlement discussions between OLDE and Tupman occurred at a meeting on August 5, 1992 between Tupman and representatives of OLDE. At that meeting, it was confirmed that Tupman was acting as the agent of the Engelhardts, representing their personal interests. (App. 55, Resp. App. 1a-8a, 13a).[4] Tupman vehemently expressed his disdain and contempt for arbitration of the Engelhardts' dispute. (Resp. App. 3a, 13a). On behalf of the Engelhardts, Tupman stated that they refused to arbitrate their civil claim; rather, they had selected the Delaware Securities Commissioner's Office to pursue their claim. (App. 55).

Also at the August 5 meeting, Tupman coerced OLDE, through prosecutorial/extortionist threats, to pay the Engelhardts the complete rescissionary value of their SNFS stock purchases. (Resp. App. 4a). If OLDE did not pay the Engelhardts full rescission, Tupman warned the OLDE representatives that they should consider the exponential costs and difficulties it would experience, including: adverse publicity; expanded investigation of OLDE with additional costly and time-consuming discovery requests and subpoenas; and notification to other regulators who, in turn, would also investigate OLDE's sales of SNFS stock to residents in their respective states. (Resp. App. 6a-7a).

Just as a private attorney would meet with his or her client to discuss settlement proposals, Tupman subsequently met with the Engelhardts to convey OLDE's settlement offer to them in the

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4. Cites to "Resp. App." refer to respondent's Appendix attached hereto.

amount of $20,375. (App. 56). The Engelhardts instructed Tupman that they rejected OLDE's offer and wanted the state to go forward with its case. (App. 56). Moreover, Tupman characterized as "baffling," OLDE's claim of its contractual right to arbitrate the Engelhardts' dispute and the federal preemption of Delaware's private rescission remedy. (App. 7).

OLDE insisted upon its federal right to arbitrate the Engelhardts' private claim and served the Engelhardts with a written demand to arbitrate their dispute, pursuant to their contract. (App. 7, 55). In turn, petitioner Hubbard issued the Notice which included the demand for rescission of the Engelhardts' SNFS stock purchases. (App. 7, 57). Tupman viewed OLDE's (contractually mandated) demand for arbitration as an attempt to "pressure" the Engelhardts into arbitration, and suggested that it was evidence of OLDE's bad faith, since he had disagreed with OLDE's legal position. (App. 56).

Facing the prospect of an administrative proceeding which would resolve the Engelhardts' private dispute with OLDE, thereby frustrating and avoiding OLDE's federal substantive right to arbitrate that dispute, OLDE chose to protect that right by commencing this action.[5] As here relevant, OLDE's Verified Complaint sought a preliminary injunction to halt petitioner's pursuit of rescission for the Engelhardts in his administrative proceeding, ostensibly authorized by the Delaware Securities Act, Del. Code Ann. tit. 6, §7325(b).[6] As pursued by petitioner,

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5. The court below held that petitioner's administrative proceeding would serve merely as a "substitute for the arbitration." (App. 18).

6. Beyond the preliminary injunction which is the subject of this appeal, the district court granted no further relief. An Amended Verified Complaint was later filed, which included alleged violations of the Civil Rights Act, 42 U.S.C. § 1983 and civil "RICO," 18 U.S.C. §§ 1961-1968. Trial on the remaining counts is now scheduled for September, 1994.

§ 7325(b) would circumvent OLDE's right to arbitration under the Federal Arbitration Act, 9 U.S.C. § 1, *et seq.* ("FAA"), and thus would violate the Supremacy Clause. (App. 8).

At the preliminary injunction hearing, in which Tupman appeared on behalf of and represented himself, petitioner Hubbard and the Engelhardts, the district court took evidence in the form of affidavits and numerous supporting documents, along with assertions/admissions by Tupman and argument from counsel. Tupman admitted in open court that these circumstances and events were "very well memorialized" and the only issue concerned the conclusions to be drawn from them. The district court, in its Memorandum Opinion, noted that the material facts were not in dispute. (App. 49). By Order dated September 16, 1992, the district court enjoined petitioner from pursuing a rescission action under § 7325(b) of the Delaware Securities Act on behalf of the Engelhardts, since their arbitration agreement with OLDE is enforceable under the Federal Arbitration Act, 9 U.S.C. § 2. (App. 75). The court declined to abstain and held that the FAA preempted the private rescission remedy of the Delaware Securities Act, § 7325(b). (App. 9, 66).

Signally, contrary to the implication of the petition, the district court did not enjoin petitioner from investigating OLDE or from pursuing administrative remedies other than private relief on behalf of the Engelhardts. (App. 21). The preliminary injunction for which the petitioner seeks review did *not* infringe upon or interfere with the state's proper role, interest or traditional state objectives in securities law enforcement. The petitioner was enjoined only from pursuing administrative proceedings and private remedies which pose obstacles to the full purposes and objectives of Congress in adopting the FAA. (App. 17, 21, 66-67).

The court below affirmed on two different grounds, holding: (1) that the FAA preempts petitioner's authority under Delaware

law to pursue private administrative relief in these circumstances, and (2) that principles of contract law preclude petitioner from pursuing private remedies in an administrative proceeding which would interfere with and "end run" around the terms of a valid arbitration agreement. (App. 3, 34). The court below also unanimously affirmed the district court's decision to intervene (rather than abstain).[7] The petitioner's authority under the Delaware statute is preempted since it authorizes relief directly in conflict with rights secured by the FAA, and necessarily presents an exception to the abstention doctrine of *Younger v. Harris*, 401 U.S. 37, 91 S.Ct. 746 (1971). The two independent grounds for the decisions by the court below are amply supported by the record, are consistent with the law favoring arbitration and therefore should not be disturbed.

REASONS FOR DENYING THE WRIT

The court of appeal's decision does not present any question which warrants review by this Court. That decision reaffirmed and applied well-settled authority on the strong federal policy favoring arbitration. An integral component of that policy, as embodied by the decision below, is that states may not disfavor arbitration by compelling the resolution of arbitral disputes into alternative state-mandated forums. In this regard, the petition raises no issue that merits review. Rather, the petition offers case-specific, fact-driven issues which have already been decided adversely to petitioner by both the district court and the court of appeals.

Reexamination of the substantial record and detailed analysis supporting the lower court's affirmance of the order of preliminary injunction is a factbound task that does not warrant certiorari. The petition raises no substantial question of law. There is no conflict in the lower courts. This case merely represents a new variation on an

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7. Petitioner's request for rehearing *en banc* was also denied.

old theme: state interference with federal substantive rights to arbitration.

I.

THE PETITION RELIES ON NEW FACTUAL ASSERTIONS TO THE EXCLUSION OF THOSE FOUND BY THE DISTRICT COURT AND THE COURT OF APPEALS.

The findings of fact below were concededly uncontroverted; and the District Court noted that the material facts were not in dispute. (App. 49). The Court of Appeals also concurred in the factual findings. Petitioner now improperly takes issue with the findings of fact, offers new facts which are not in the record below and suggests that some of the findings were "erroneously labeled 'undisputed'." (Petition for Writ of Certiorari, hereinafter "Pet." 5). Signally, petitioner never sought reconsideration of the findings in the district court. Now, in hindsight, petitioner inappropriately requests this Court to review evidence, take new "evidence" and discuss specific facts. The petition is ill-advised in that it seeks review of a decision which presents primarily a question arising out of the particular facts involved. For this reason alone, the petition is improvident and should be denied. *National Labor Relations Board v. Hendricks County Rural Electronic Corp.*, 454 U.S. 170, 176, n. 8 (1981); *Texas v. Mead*, 465 U.S. 1041 (1984) (Stevens, J.).

Beyond its omission of the central, relevant facts and circumstances upon which the decisions rest, the petition offers new "facts" in an attempt to controvert the heretofore "undisputed" facts. For example, the petition takes issue with a factual finding concerning the Engelhardts' investment objectives, offering new hearsay allegations in a belated attempt to rebut the findings. (Pet. 5, n. 2). Similarly, the petition claims that the court of appeal's description of OLDE's business in 1990 is incorrect. In support of

its assertion, the petition references a brochure, allegedly sent by OLDE to Delaware residents in August 1993, more than three years after the relevant period encompassed by the Engelhardts' 1990 stock transactions. (Pet. 6, n. 3). The referenced "brochure" is found nowhere in the record below, which explains petitioner's lack of citation to the record on this new factual assertion. The petition also takes issue with the district court's finding that OLDE's settlement offer would have fully compensated the Engelhardts for their loss in SNFS during the period they held their stock at OLDE, suggesting that the court overlooked other "facts" now offered in the petition. (Pet. 9, n. 5). These examples demonstrate petitioner's displeasure with the "undisputed facts." In this regard, the petition raises fact-driven issues and therefore should be denied.

II.

THE DISTRICT COURT AND THE COURT OF APPEALS APPLIED THE PROPER PREEMPTION ANALYSIS IN THAT PETITIONER'S IMPLEMENTATION OF DELAWARE LAW INTERFERES WITH FEDERAL ARBITRATION RIGHTS GRANTED BY THE FAA.

Given the peculiar facts and circumstances of this case, both lower courts correctly found that federal preemption was appropriate, in that petitioner's pursuit of private remedies in an administrative forum would interfere with and create an obstacle to OLDE's federal rights under the FAA. Delaware created a statutory scheme which, as implemented by petitioner here, circumvents and forecloses federal arbitration rights. The aggravating record below demonstrates that petitioner's Notice was issued solely to assert and adjudicate the Engelhardts' civil claim in the administrative forum, in retribution for OLDE's failure to settle that single claim on terms demanded by Tupman, in

violation of OLDE's federal substantive right to arbitrate that dispute. The court of appeals correctly perceived the state-created conflict, noting that petitioner sought to "adjudicate administratively the very same [claim] that the Engelhardts themselves could pursue only within an arbitration." (App. 17).

This Court has historically and routinely accorded preemptive effect to the FAA, invalidating state laws that discriminate against, circumvent or create obstacles to the enforcement of federal arbitration rights. *See generally Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1 (1983); *Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985); *Perry v. Thomas*, 482 U.S. 483 (1987); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987); *Rodriguez De Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. __, 111 S. Ct. 1647 (1991). *See also Osterneck v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 841 F.2d 508 (3d Cir. 1988); *Securities Industry Assoc. v. Connolly*, 883 F.2d 1114 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990).

Although petitioner disagrees with the preemptive force of the FAA, the petition ignores the longstanding preemption rationale which was correctly applied by the courts below. Rather, in a desperate attempt to incite interest, the petition incorrectly states that the decision below "blatantly disregards" this Court's holding in *Gilmer, supra.* (Pet. 14). Contrary to this bald assertion, both the district court and the court of appeals below expressly considered and followed the teachings of *Gilmer.* (App. 62-63, 15, 19-20, 42-43). In *Gilmer,* this Court rejected any contention that the involvement of a federal administrative agency (Equal Employment Opportunity Commission) in a statutory scheme of enforcement was sufficient to preclude arbitration of those claims. In the face of this clear and expansive holding, petitioner clings to *dicta* in that decision which stated that the EEOC is not precluded

from bringing an action seeking "class-wide and equitable relief." *Gilmer,* 111 S. Ct. at 1655.

However, petitioner's reliance upon that language has no relevance to the facts in this case. Significantly, as the court below noted, petitioner was *not* seeking "class-wide equitable relief" in the Notice issued against OLDE. (App. 20, n. 5). Rather, petitioner's Notice expressly sought rescission specifically on behalf of the Engelhardts, a claim which was bound to arbitration. The court below considered and correctly rejected petitioner's contention that *Gilmer* establishes that the state's interest in the private remedy of rescission should be given "special exemption" from traditional preemption principles. (App. 20). Simply, the issue of "class-wide relief" in the context of federal arbitration rights will not be before this Court if the petition is granted.

Similarly, petitioner's "distinction" between restitution and damages, and the so-called "public interest" in the remedy of rescission are both illusive under these circumstances. (Pet. 18, 23-24). In *Gilmer,* this Court expressly considered and dismissed such veiled distinctions. Specifically, in the context of a private claim which the Court held was required to be decided in an arbitral forum, the Court noted:

> It is true that arbitration focuses on specific disputes between the parties involved. The same can be said, however, of judicial [administrative] resolution of claims. Both of these dispute resolution mechanisms nevertheless also can further broader social purposes. The Sherman Act, the Securities Exchange Act of 1934, RICO, and the Securities Act of 1933 all are designed to advance important *public policies,* but, as noted above, claims under those statutes are

> appropriate for arbitration. "[S]o long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial [private interest] and deterrent [public interest] function." *Gilmer, supra,* at 1653 (emphasis supplied), citing *Mitsubishi, supra,* at 637.

Clearly, the totality of the factual record below demonstrates that petitioner's institution of the administrative proceeding against OLDE was not in the "public interest," but was instead instituted solely *on behalf of* the Engelhardts, as the district court found. (App. 75). The private claim which petitioner was pursuing on behalf of the Engelhardts in the administrative proceeding would clearly be subject to arbitration if pursued directly by the Engelhardts themselves. Tupman, as Deputy Attorney General, using the power of his title and office was, in effect, the *de facto* attorney for the Engelhardts.

The court below correctly held that preemption was appropriate, given the "community of interest" among petitioner, Tupman and the Engelhardts, which "implicitly demonstrates that the administrative proceedings are an obstacle to Congress' purpose in adopting the FAA." (App. 17). Simply put, preemption was necessary since petitioner was attempting to do indirectly what the Engelhardts could not do directly (*i.e,.* avoid arbitration).[8]

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8. Petitioner's reliance upon *Porter v. Warner Holding Co.*, 327 U.S. 395 (1946) and *Kelly v. Robinson,* 479 U.S. 36 (1986) is misplaced. In *Porter,* the tenants who benefitted from an award of restitution could *not* have brought their own private actions to recover rent overpayments. In contrast, the Engelhardts could have brought their own claims, in arbitration, but were relying on petitioner "to obtain a remedy that would frustrate the arbitration." (App. 17). Although neither case concerned federal arbitration rights, both cases involved *bona fide* government proceedings seeking "class-wide" as opposed to singular equitable relief.

Moreover, contrary to the petitioner's suggestion, the state putative "public interest" will not be substantially interfered with by the decision below. In this regard, the district court did not enjoin petitioner from pursuing any other administrative remedies; only private rescission of the Engelhardts' purchases.[9] Therefore, petitioner retains many avenues for its pursuit of proper state objectives in securities law enforcement.

Petitioner stretches the boundary of plausible argument in suggesting that the decision below is "incorrect." (Pet. 21). Specifically, petitioner takes issue with the decision below which effectively held that the federal right to arbitrate would be "meaningless" if petitioner could order private rescission to the Engelhardts in the administrative proceeding. Fundamentally and practically flawed, petitioner suggests that OLDE might still derive a "great benefit" from its arbitration agreement even if petitioner were allowed to order rescission on behalf of the Engelhardts. (Pet. 21). Such an illogical contention was correctly dismissed by the court below. (App. 16-19).

The reality is that the Engelhardts did not initiate an arbitration claim against OLDE as required by their arbitration agreement. Rather, as the court of appeals observed, they relied upon petitioner and Tupman to obtain a private remedy which would circumvent the arbitration. (App. 17). Petitioner's suggestion of harmony between the state's private rescissionary statute and the FAA is "illusory," as found below. (App. 18). If, for example, petitioner awarded rescission to the Engelhardts in his administrative proceeding, clearly there would be no arbitration of the dispute, since the Engelhardts would receive full rescission in the administrative proceeding. In such a case, OLDE's federal right to arbitrate would be meaningless.

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9. As discussed at pp. 16-17, 21 below, this argument is a "red herring" since, in this particular case, there was no issue of state or public interest; any such interest having been resolved. (App. 6-7).

Moreover, as the court below correctly observed, if forced to defend the Engelhardts' claim in the state's administrative proceeding, OLDE "would be deprived of its right to the presumed simplicity and efficiency of the arbitral forum." (App. 19). Therefore, the private rescission remedy, as implemented here by petitioner on behalf of the Engelhardts, would completely eviscerate OLDE's federal arbitration right. The court below correctly held that the state's private rescission remedy is preempted by the FAA since it "presents an obstacle to the accomplishment of the congressional purpose of enforcing arbitration agreements, and because it is impossible to give effect to both the administrative rescission remedy and the federal right to arbitration." (App. 19). The decision is consistent with the broad and unbroken line of decisions by this Court favoring arbitration in the face of a state's attempt to bypass federal rights to arbitrate.

III.

THE FAA REQUIRES ENFORCEMENT OF ARBITRATION AGREEMENTS AGAINST NON-SIGNATORIES TO THE AGREEMENT.

Petitioner contends, without citation to any authority, that since he was not a party to the arbitration agreement, he cannot be bound by its terms. (Pet. 13, 22). This concept was, contrary to the petition, *not* ignored. The court below considered this point, but did not alter its decision. Reminiscent of this Court's opinion in *Moses H. Cone Memorial Hospital,* the court of appeals stated that under the FAA "an arbitration must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement." (App. 18), citing, *Moses H. Cone Memorial Hospital, supra,* 460 U.S. at 20. Numerous other federal court decisions have held that nonsignatory agents of principals are bound by the terms of the arbitration agreement. *See generally Barrowclough v. Kidder, Peabody & Co., Inc.,* 752 F.2d

923 (3rd Cir. 1985) (employee and nonsignatory contingent beneficiaries bound by arbitration agreement); *Letizia v. Prudential Bache Securities, Inc.*, 802 F.2d 1185 (9th Cir. 1986) (employees/agents who were nonsignatories to a customer brokerage agreement could be bound by the arbitration clause); *In Re Oil Spill by Amoco Cadiz, et al.*, 659 F.2d 789 (7th Cir. 1981) (nonsignatory agent bound to arbitration where purposes of FAA would not be advanced if agent were allowed to disavow principal-agent relationship for purposes of arbitration).

The court below had ample evidence upon which to conclude that petitioner was acting as agent of the Engelhardts, parties to the arbitration agreement, and therefore bound by its terms. First, the district court necessarily found that petitioner was expressly pursuing private rescissionary relief "on behalf of the Engelhardts." (App. 75, 67). Indeed, the administrative proceedings were instituted based solely upon the Engelhardt's complaint; the Notice itself was predicated exclusively upon the dispute between OLDE and the Engelhardts. (App. 17, 20, n. 5).

The record below fully supports the conclusion that petitioner's administrative proceeding would merely be a substitute for the arbitration. (App. 18). There was no "public interest" in the state's pursuit of private relief for the Engelhardts. Tupman had agreed to accept OLDE's $15,000 contribution to the Investor Protection Fund to resolve any putative state public interest. (App. 7), (Resp. App. 4a). The purpose of the administrative proceeding was to pursue the private interests of the Engelhardts, which the district court found. (App. 75).

The principal-agent relationship among petitioner, Tupman and the Engelhardts was described by the court below as a "community of interest" in the Engelhardts' complaint. (App. 17). Not unlike a private attorney, Tupman met with the Engelhardts to discuss OLDE's settlement proposal. (Resp. App. 13a). The

Engelhardts instructed Tupman to proceed with the administrative proceedings and, in retaliation for OLDE's demand to arbitrate the dispute, Tupman and petitioner instituted the proceedings.[10] Before the district court, Tupman *refused* to bifurcate the state's pursuit of rescission for the Engelhardts (a private interest) from the remainder of the administrative proceeding (the public interest). (App. 26, n. 9). Furthermore, as the court below also recognized, Tupman filed the appeal on behalf of the Engelhardts, who were not represented by separate and independent counsel on either the appeal or in the earlier settlement negotiations with OLDE. (App. 17).

Based upon this abundance of evidence, it is clear that petitioner and his agent Tupman stepped into the shoes of the Engelhardts and instituted administrative proceedings not for any "public purpose," but solely to pursue private rescission for the Engelhardts. Without the district court injunction, the Engelhardts, through the assistance of their agents, petitioner and Tupman, acting through the subterfuge of the administrative proceeding, would have been able to "end run" around the arbitration. Such a result would defeat the FAA's fundamental purpose: a national policy which favors arbitration and withdraws the power of states to require an alternative forum for the resolution of claims which the parties agreed to resolve by arbitration. *Southland Corp., supra,* 465 U.S. at 10.

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10. Curiously, Mr. Tupman has not joined in this petition, notwithstanding findings that his actions were not on behalf of the state, but on behalf of the private interests of Mr. & Mrs. Engelhardt. (App. 17).

IV.

IN CIRCUMSTANCES WHERE A STATE STATUTORY REMEDY IS IMPLEMENTED BY STATE OFFICIALS TO CIRCUMVENT FEDERAL RIGHTS TO ARBITRATION, THE FAA NECESSARILY PROVIDES AN EXCEPTION TO THE *YOUNGER* ABSTENTION DOCTRINE.

The district court and the court of appeals concluded that the abstention doctrine of *Younger v. Harris*, 401 U.S. 37 (1971) was not applicable to OLDE's claim of federal entitlement to arbitration under the FAA. (App. 3). Petitioner's suggestion that the court below "carved out a new exception for FAA preemption claims" is incorrect. (Pet. 25). Rather, the court appropriately balanced the confrontation between the normal limits of *Younger* abstention against the "highly favored" and congressionally mandated right to arbitration. (App. 30). The court below resolved the collision between these two competing interests in favor of arbitration, since deference to the petitioner's administrative proceeding would present a significant and immediate potential for irreparable harm to the federal interest asserted. (App. 25-26), citing *Wooley v. Maynard*, 430 U.S. 705, 710 (1977); *Ohio Civil Rights Commission v. Dayton Christian Schools, Inc.*, 477 U.S. 619, 626 (1986); *Harman v. Forssenius*, 380 U.S. 528, 537 (1965).

In these unusual circumstances, where petitioner instituted administrative proceedings, yet OLDE, under the auspices of the FAA, is guaranteed in the first instance an arbitral forum in which to resolve the Engelhardt's dispute, the delay inherent in waiting for guidance from the state appellate court *after* petitioner's administrative proceeding is concluded would necessarily result in great and immediate irreparable injury, since OLDE's federal right would be rendered meaningless and lost forever. *Id.* Therefore, the

courts below properly intervened to protect OLDE's rights under Section 2 of the FAA.

This Court has instructed that the doctrine of abstention "is an extraordinary and narrow exception to the duty of the District Court to adjudicate a controversy properly before it . . . ." *Colorado River Water Conservation Dist. v. United States,* 424 U.S. 800, 813 (1976). Therefore, "[a]bstention rarely should be invoked." *Ankenbrandt v. Richards,* 504 U.S. __, 112 S. Ct. 2206, 2215 (1992).

There can be no dispute, as the district court noted, that petitioner (and Tupman) were "engaged in a course of action openly inconsistent with [OLDE's] rights under Section 2 of the FAA . . . ." (App. 30). In these circumstances, OLDE cannot be turned away from federal court by petitioner's expedient invocation of *Younger* abstention. The very nature of OLDE's contractual right, as sanctioned by the FAA, is to have claims addressed in an arbitration forum in the first instance. The court below correctly observed that if the district court abstained in this case, it would be refusing to protect, and OLDE would suffer immediate irreparable harm to, federal rights established by the FAA. (App. 27-28).

Petitioner's argument, rejected below, would obviously evade federal arbitration rights rendering those rights meaningless.

Petitioner's insistence upon pursuing administratively, a private rescission remedy in conflict with OLDE's right to an arbitral forum under the FAA presents "the very unusual situation that an injunction is necessary to prevent great and immediate irreparable injury." *Ohio Civil Rights Commission, supra,* at 626.

Hence, the court below correctly noted that OLDE's procedural right to an arbitration forum is "raised to a substantive

right by the FAA." (App. 28). The district court appropriately intervened to uphold and protect that right. This Court intervened in a similar case where a person bound to arbitration ignored and avoided the arbitration requirement and instead resorted to the courts. *Southland Corp., supra,* 465 U.S. at 6-8. *Southland* instructs federal courts not to stand idle while the FAA's mandate is evaded. (App. 28).[11]

Beyond the reasons articulated by the court below, the record fully supports intervention for another reason as well. Important state interests implicating *Younger* are not raised in circumstances as here, where state officials abuse state process to violate federal constitutional and statutory rights. *Heritage Farms, Inc. v. Solebury Township,* 671 F.2d 743, 748 (3rd Cir. 1982), *cert. denied,* 456 U.S. 990 (1982); *Gwynedd Properties, Inc. v. Lower Gwynedd Township,* 970 F.2d 1195, 1202 (3rd Cir. 1992). The abusive manner by which these proceedings have been pursued overshadows any legitimate interest which the state might otherwise have in the enforcement of the underlying statute. Although Delaware may have an important interest in policing the securities industry, that interest is not furthered (or even served) by petitioner's (and prosecutor Tupman's) use of the Delaware Securities Act as an implement for coercing private settlements on behalf of investors who are otherwise bound to arbitrate their claims. As in *Gwynedd Properties* and in *Heritage Farms,* the

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11. The pervasive and expansive enforcement of arbitration rights and the need for federal intervention when arbitration rights are challenged, can be gleaned from the congressional intent reflected directly in the FAA, 9 U.S.C. § 16. That section, entitled "Appeals," provides that while orders compelling arbitration are not immediately appealable, orders denying requests to compel arbitration are immediately appealable. The court below noted that "[t]his dichotomy reflects the paramount importance that Congress has placed on arbitration . . . [granting] the Courts of Appeals broad authority to ensure that district courts are not circumscribing the rights granted by the FAA . . . ." (App. 29).

conduct here is so outrageous as to transcend any putative state interest which might otherwise justify federal abstention. Moreover, *Younger* has always excepted from its scope those state proceedings that are not "good faith attempts" to enforce a state statute. *Younger, supra,* at 54.

Finally, the district court's intervention was carefully limited to protect OLDE's federal rights to arbitration, but did not interfere with petitioner's putative public interest in state securities law enforcement. The court of appeals noted this limitation approvingly, as well. (App. 20-21, 36, n.1). The order of preliminary injunction did not usurp the state's power to enforce its securities law generally, nor did it restrain petitioner's administrative proceedings against OLDE. The decision to intervene was vital since "delayed enforcement destroys the federal statutory right." (App. 31).

CONCLUSION

For the foregoing reasons and controlling authorities, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX

The attached documents, part of the record below, were referenced and relied upon by the district court and court of appeals in reaching their decisions. (App. 7, 17, 53-56).

APPENDIX A — JOINT VERIFIED STATEMENT

Joint Verified Statement

This Verified Statement is subscribed and sworn to jointly by Randal J. Mudge, Bruce A. Campbell and J. Richard Tucker based upon their personal knowledge and belief.

On August 5, 1992, a meeting took place between representatives of the Office of the Attorney General of the State of Delaware and OLDE Discount Corporation ("OLDE"), a broker-dealer. The meeting was held at the request of OLDE. Deputy Attorney General W. Michael Tupman and securities Investigator F. Gregory Gause, Jr. attended the meeting on behalf of the State of Delaware. Randal J. Mudge, Managing Director and CEO of OLDE, Bruce A. Campbell, Corporate Attorney and J. Richard Tucker, special counsel, attended on behalf of OLDE. The meeting commenced at approximately 10:30 AM at the offices of Mr. Tupman in Wilmington, Delaware.

At the outset of the meeting, Mr. Tupman referred to a recent broker-dealer revocation action instituted by the State against another securities brokerage firm. Mr. Mudge responded and presented a brief history of OLDE in order to distinguish OLDE from the firm whose broker-dealer registration had recently been revoked by the State Securities Commissioner. In response, Mr. Tupman stated in substance that:

> We do not consider you [OLDE] to be in the same class as that firm, we consider Hibbard Brown to be at one end of the spectrum and OLDE to be at the other end. It is because we consider you to be at the level of the most honorable of firms, that we have a higher standard for you and we have greater expectations from you.

Mr. Tucker then stated that he did not believe or understand that Donohoe's alleged conduct to be fraudulent, and that the alleged omissions concerning the impact of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, enacted August 9, 1989 ("FIRREA"), on Second National Federal Savings ("SNFS"), (as contained in the draft Notice sent to OLDE by Mr. Tupman) were harmless omissions, even if it was omitted from Donohoe's discussions with the Engelhardts. Mr. Tucker noted that conditions in the Savings and Loan Industry as well as the U.S. government's efforts to improve the capital for thrifts were common knowledge because they had been enacted almost a full year before the Engelhardts' purchases and were the subject of daily writings and discussions by both the print and broadcast media. In response, Mr. Tupman stated in substance that:

> The Engelhardts are unsophisticated investors and they would have needed such an explanation.

The conversation then turned to the issue of the State pursuing penal sanctions at the same time it was negotiating a civil settlement on behalf of the Engelhardts. OLDE representatives urged the State to bifurcate its enforcement activities from the interests of the Engelhardts by accepting OLDE's offer of settlement which had previously been negotiated with the State (i.e. payment of $15,000.00 to the Delaware Investors Protection Fund in return for the State closing of its files without the filing of any complaint). In response, Mr. Tupman stated in substance that:

> Oh you brokers would love nothing more! You brokers 'never' respond to customer complaints! You never pay off complaining clients, you force customers to sign arbitration

> agreements and you always force the claimants to go to arbitration which is stacked against them! Brokerage clients cannot go to lawyers for redress in the courts because (1) it takes forever; (2) the clients get terrible results; (3) the clients have the costs of litigation, including legal fees; and (4) you brokers would love nothing more than to force a client into a settlement! The Engelhardts are not going to arbitration and they are not going into the state or federal courts because, as I said earlier this morning, they have chosen their remedy which is rescission under Section 7325(b) of the Delaware Code!

OLDE representatives once again reiterated its offer to pay a fine or penalty in the amount of $15,000.00 to the Delaware Investor Protection Fund, to settle the charges without publicity or any formal proceeding, particularly since the State agreed that the alleged misconduct did not amount to securities fraud, because the State offered to close its files without the filing of any public notice or action in return for such payment, and OLDE considered the absence of adverse publicity to be advantageous. In response, Mr. Tupman stated in substance that:

> We can understand why you would like to avoid the bad publicity, but we will settle with you only if you repay the Engelhardts in full ($52,875.00).

OLDE representatives inquired as to whether the State had any disagreement with the portion of the settlement which included the payment of $15,000.00 to the Delaware Investors

Protection Fund. In response, Mr. Tupman stated in substance that:

> No, as we have stated, we are in agreement on that. OLDE's proposed contribution is acceptable. The only remaining question is whether rescission or restitution for the Engelhardts is appropriate. We believe that rescission in the amount of $52,875.00 is appropriate.

Mr. Tucker stated that the application of amended Section 7325(b), in the contemplated matter, was inappropriate for two reasons. First, the alleged misconduct occurred prior to the Delaware legislature's enactment of amended Section 7325(b) and that such an application would amount to a violation of the due process clauses of the U.S. and Delaware Constitutions as an *ex post facto* law. Second, OLDE representatives suggested that the imposition of such a remedy was in violation of the Due Process clauses of both the U.S. and the Delaware State Constitutions if, as it appeared, the office of the State Attorney General was, in effect, forcing the settlement of civil litigation (with the Engelhardts) by threatening penal actions including fines and revocation of OLDE's broker-dealer registration, unless OLDE paid the amount demanded by the State to settle any potential civil litigation with the Engelhardts. In response, Mr. Tupman stated in substance that:

> Delaware is one of the few jurisdictions which have such (rescission/restitution) legislation and we intend to pursue it vigorously even if those other jurisdictions don't want to help their citizens. None of the other States and none of the self-regulatory bodies are imposing such remedies and I am the only one who is

> doing my job. I certainly resent you coming in here and giving me a first year law student lecture. We [the office of the securities Commissioner] have recently upheld this Section in the Hibbard Brown matter and this is the law in Delaware, even though that decision is now being appealed from the Administrative process to the Delaware Court of Chancery, this is the law in Delaware!

OLDE representatives then suggested that the State Attorney General was in an awkward ethical dilemma. It appeared as if Mr. Tupman was providing private legal advice to the Engelhardts [by advising them concerning OLDE's settlement offer to them and counselling that they ignore OLDE's offer and pursue a remedy under amended Section 7325(b)], while simultaneously purporting to act as the State's lawyer [which has somewhat different interest from those of the Engelhardts] in its ostensible pursuit of penal enforcement proceedings against OLDE. In response, Mr. Tupman stated in substance that:

> We will have to terminate this meeting. If you are suggesting that I am doing something unethical then you are really skating on thin ice! I am a representative of the State and I resent you implying that I would do anything unethical, and if you are suggesting that I am, then we will terminate this meeting!

OLDE representatives then suggested that the Engelhardts had failed to mitigate any damages which may have been caused by OLDE or its agents, if in fact OLDE's actions resulted in any damages, and that no court or arbitrator would be likely to

conclude, as a matter of law, that OLDE should pay the full amount of $52,875, even if there was a finding of liability. Accordingly, the State's insistence upon rescission of the total amount that the Engelhardts invested was tantamount to OLDE becoming a guarantor of the performance of its clients' investments. Therefore, management of OLDE, while expressing a desire to resolve this matter through settlement, couldn't justify such resolution under the patently unreasonable economic terms demanded by the State. In response, Mr. Tupman stated in substance that:

> I am not certain you have considered the economics of the exponential difficulties which you will experience if you do not accept the State's offer. First, there will be adverse publicity for OLDE. Have you considered the exponential costs of responding to all of the fifty states when we notify them of our action, and to the Exchanges and the other self-regulators? You will have to amend your U-6 (Uniform Registration Form) with all the regulators, in order to notify them of the institution of our action and again with the results of our Proceedings. We will expand this investigation with respect to Delaware residents and the other states will investigate OLDE's sales of SNFS in their states. We will file additional discovery requests and issue subpoenas which will be time consuming and costly for you to answer. It will be very costly if we conduct a full-bore SNFS investigation. When you consider the exponential effect and the economics of all of those actions, then

> maybe you will think that our offer is not so unreasonable and you will accept it (to avoid these consequences).

In closing, Mr. Tucker indicated that there would be a letter following this meeting which letter would memorialize the points made during the meeting. In response, Mr. Tupman stated in substance that:

> I strongly advise that a letter memorializing our meeting should not be sent! Why would you do that? You do not want to do that. You indicated that you didn't want publicity and I could not protect such a letter under the Freedom of Information Act ("FOIA"). I could protect our previous correspondence under FOIA, but I would be unable to protect a letter confirming this meeting. I would not appreciate disclosure of my deliberative process.

Nevertheless, shortly after the meeting, OLDE delivered to Mr. Tupman a letter dated August 5, 1992 which memorialized the substantive points raised by OLDE representatives in their meeting with Mr. Tupman and Mr. Gause. A copy of the letter delivered to Mr. Tupman is contained in the Appendix Exhibit J.

Appendix A

JOINT VERIFICATION

The undersigned: Randal J. Mudge, Chief Executive Officer of the plaintiff; Bruce A. Campbell, Corporate Attorney of the plaintiff; and J. Richard Tucker, an outside attorney and consultant to the plaintiff hereby verify, under the penalty of perjury under the laws of the United States of America, that the undersigned have read the attached joint verified statement and the statements contained therein are true and correct.

/s/	/s/	/s/
Randal J. Mudge	Bruce A. Campbell	J. Richard Tucker

APPENDIX B — AFFIDAVIT OF MICHAEL TUPMAN

IN THE UNITED STATES DISTRICT COURT
DISTRICT OF DELAWARE

CivilAction No. 92-498

OLDE DISCOUNT CORP.,

Plaintiff,

v .

W. MICHAEL TUPMAN, Deputy Attorney General, and RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware,

Defendants.

AFFIDAVIT OF W. MICHAEL TUPMAN

STATE OF DELAWARE

NEW CASTLE COUNTY : ss

W. MICHAEL TUPMAN, being duly sworn, states as follows:

1. I am a Deputy Attorney General in the Securities Division of the Delaware Department of Justice. I make this affidavit in opposition to the motion of Olde Discount Corporation ("Olde Discount") for a temporary restraining order and preliminary injunction. I have personal knowledge of all of the facts set forth herein.

Appendix B

2. In July 1991, the Securities Division received a complaint from a Wilmington couple (the Engelhardts) against Olde Discount and one of its former agents, Michael Donohoe, with regard to the purchases of stock in Second National Federal Savings Bank in May and June of 1990. The Engelhardts had lost almost their entire investment in those securities ($52,000). The Division sent a letter to the firm on July 31, 1991 asking for their response, in writing, to the complaint. By letter dated October 24, 1992, the firm responded denying that Donohoe had made any misrepresentations or failed to disclose material facts in connection with those sales of stock, or otherwise violated the state securities law.

3. Then followed a Series of requests for documents and information from Olde Discount over the course of December 1991-April 1992. Among other things, by letter dated February 6, 1992, the Division asked for a list of all Delaware investors who bought SNFS stock from Olde Discount in 1989 and 1990; the State had good reason to believe that there might have been other Delaware residents victimized by Donohoe. Olde responded, however, by saying that "our computer system is unable to generate such a list . . . . Manually generating such a list by state would be very time-consuming. If this information is vital to your investigation we will provide it. Please advise."

4. During a telephone conversation with Olde Discount's corporate counsel (Bruce A. Campbell), Mr. Campbell asked if I would notify him in advance of taking any action against the firm (if any were contemplated), to allow Olde a further opportunity to respond to any allegations. I agreed to extend Mr. Campbell this courtesy.

5. By late May 1992, the Division had completed its

investigation of the Engelhardts' complaint, and determined that there was probable cause of as many as fifteen violations of the Delaware Securities Act. Rather than recommending to the Commissioner that charges be issued at that time, however, I sent a draft of the charges to Mr. Campbell by overnight courier on June 5, 1992. Mr. Campbell then called to ask that I take no further action until Olde had a chance to review the charges, and I agreed.

6. In a telephone conference on July 13, 1992, Olde Discount made a settlement offer that would have paid the investors less than half of their investment loss. On July 17, 1992, I countered their offer asking for rescission of the stock trades (any settlement being subject to the approval of the Commissioner). Olde Discount then asked to meet with me in Wilmington and I agreed. The meeting took place on August 5, 1992 in the offices of the Securities Division.

7. I attended that meeting with one of my investigators, F. Gregory Gause, Jr. (The Commissioner did not attend that meeting, or otherwise participate in any way in the settlement negotiations.) Olde Discount was represented by a Richard Tucker, who purported to be advising them on issues of Delaware law, but I later learned that he is not admitted to practice in this State. Far from a negotiation, it quickly turned out that Olde Discount was only there to reiterate its previous settlement offer. Mr. Tucker stated his opinion that the State had less than a "ten percent" chance of prevailing on the merits, and expounded on various legal defenses such as pre-emption. He referred to the Delaware Securities Act as "dysfunctional," and suggested that the Division should simply ignore its statutory mandate and do nothing to help individual investors. Mr. Tucker also suggested that I had been providing legal advice to the Engelhardts, which I categorically denied because that is false. At no time, before or

after that meeting, have I ever purported to provide legal advice to the Engelhardts.

8. It is not true, as stated in Olde's Joint Verified Statement, that the State had "agree[d] that the alleged misconduct did not amount to securities fraud." In drafting and then issuing the notice of intent, the State clearly had found probable cause of numerous violations of the Delaware Securities Act. As to any alleged "threats," at no time did I ever threaten to recommend that an administrative proceeding be brought in order to try to force a settlement. Indeed, the charges had already been drafted, and it was only to accommodate Olde's request that the State delayed in issuing the charges.

9. As in any settlement negotiations of this kind, the respondents often ask that the matter be kept confidential. As I explained to Olde Discount at the meeting in Wilmington, as a public agency the Securities Division cannot cloak its activities in secrecy, since we are subject to such statutes as the Freedom of Information Act. In addition, I explained to them that because of the reciprocal system of enforcement under the Uniform Securities Act, any administrative proceeding in Delaware would necessarily be public. Accordingly, if we were not able to come to some sort of agreement before charges issued, it would be virtually impossible to negotiate at some future point about this issue.

10. After the settlement meeting, the Division learned for the first time that despite Olde Discount's repeated misrepresentations to the contrary, the investors had complained in July 1990 to Olde Discount's home office in Detroit, Michigan, but had been told by a vice president of the firm that there was no basis for their complaint. This is an important fact, because Olde contends that if they had been notified of a complaint by the Engelhardts, they

would have been in a position (hypothetically) to have redressed the wrong at that time. Although Olde Discount's compliance manual requires that the firm maintain written customer complaint files, no record was created by the firm in this case.

11. I met with the Engelhardts on August 10, 1992 to inform them that Olde Discount had made a settlement offer. I emphasized that I was not their attorney and could not give them legal advice, and also that the final decision would rest with the Division and the Commissioner, since we had the larger public interest to consider. Nevertheless, we wanted their input, and I explained that there were two possible scenarios: either they could receive a sum certain now, or else go to a hearing, where the outcome was problematic. Even if the Commissioner ruled in their favor, that decision could be appealed, and they might not see any money for a long time. Both the Engelhardts emphatically agreed that they wanted the State to go forward with its case.

12. It was only at this meeting with the Engelhardts that the Division learned that on the very same day of the settlement conference in Wilmington, Olde Discount had served by hand-delivery on the Engelhardts a demand for them to invoke NASD arbitration, or Olde would do it on their behalf. Thus, while Olde Discount was purporting to try to settle the case, they were starting a "race to the courthouse" to try to initiate an NASD arbitration before the State commenced its administrative proceeding.

13. I wrote to Olde Discount on August 10, 1992 to bring this matter to their attention, and to reject the firm's final settlement offer. The Division also renewed its request (though much more narrowed in scope) of February 6, 1992 for a list of Delaware residents to whom Donohoe had sold SNFS stock during the seven months that he worked at Olde Discount.

Appendix B

14. At an impasse, with settlement negotiations completely broken down, the Division recommended to the Commissioner that a notice of intent to suspend or revoke broker-dealer registration be issued. The Commissioner agreed, and signed an order that same day giving Olde Discount thirty days to request a hearing on the matter. (A copy of the notice and order are attached to this affidavit as Exhibit 1.) To date, Olde Discount has not requested a hearing.

15. On August 17, 1992, the Department of Justice issued a press release concerning the notice of intent against Olde Discount and Donohoe after the charges had been filed. An article reporting the notice appeared the next day in the *News-Journal,* and in response to that article, the Division received a number of new complaints from Delaware investors who also had bought SNFS stock from Donohoe. In addition, the Division has contacted some other investors similarly situated, not to "foment" new complaints, as Olde Discount alleges (without any factual basis), but rather merely to inquire if they had any problem with their investment. The investigations are in accordance with the Division's statutory mandate.

16. On August 19, 1992, again pursuant to its standard operating procedures, the Division gave notice over a computer wire (known as the CRD) to all other state securities agencies of the pending disciplinary proceeding in Delaware. To date, the Division has not received a response from any other state. It is simply false for Olde Discount to allege (without any factual foundation) that the Division is "fomenting" disciplinary proceedings in other states.

Appendix B

/s/
W. Michael Tupman

Subscribed to and sworn
before me this 26th day
of August, 1992

/s/
Notary Public

Supreme Court, U.S.
FILED
DEC 22 1993
CLERK

No. 93-680

In The

Supreme Court of the United States

October Term, 1993

RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware,

Petitioner,

v.

OLDE DISCOUNT CORPORATION,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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Federal Arbitration Act, 9 U.S.C. §§ 1-16 ..... *passim*

42 U.S.C. § 1983 2

Del. Code Ann. tit. 6, § 7325(b) 6

Del. Code Ann. tit. 29, § 2504(9) 6

No. 93-680

In The

Supreme Court of the United States

October Term, 1993

RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware,

Petitioner,

v.

OLDE DISCOUNT CORPORATION,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

REASONS FOR GRANTING THE WRIT

I. THERE IS AN INTER-CIRCUIT SPLIT ON THE ISSUE OF *YOUNGER* ABSTENTION WHERE A PLAINTIFF PURSUES FEDERAL INTERVENTION RATHER THAN PRESENT HIS OR HER FEDERALLY-BASED CLAIMS AS A DEFENSE IN A STATE ADMINISTRATIVE PROCEEDING.

Because Olde Discount Corporation ("Olde") filed this federal action in advance of Delaware's administrative hearing on the charges of securities violations by Olde, the abstention doctrine of *Younger v. Harris*, 401 U.S.

37 (1971), is at issue here. Though the Third Circuit Court of Appeals panel issued three separate opinions on the Federal Arbitration Act ("FAA") preemption issue, it unanimously agreed that *Younger* abstention did not apply. The court of appeals' holding as to abstention has, however, since the filing of the Petition on October 28, 1993, been contradicted by an opinion in another circuit. Recent authority from the Ninth Circuit Court of Appeals contradicts the holding in this case on the issue of *Younger* abstention. In the immediate case, the court of appeals below held that *Younger* abstention is discretionary even when its three elements are present: (1) there is a pending state proceeding that is judicial in nature, (2) an important state interest is implicated in the proceeding, and (3) there is an opportunity for the federal plaintiffs to raise their constitutional claims as a defense in the state proceeding or on appeal. (Pet. App. at 25). However, the Ninth Circuit Court of Appeals, citing *Ohio Civil Rights Commission v. Dayton Christian Schools, Inc.*, 477 U.S. 619 (1986), and *New Orleans Public Service, Inc. v. City Council of New Orleans*, 491 U.S. 350, 369 (1989), has held that federal abstention is "required" when all three elements of *Younger* abstention are present. *Nevada Entertainment Industries, Inc. v. City of Henderson*, Nos. 92-17054, 93-15052, 1993 WL 440224 (9th Cir. Nov. 2, 1993) (per curiam). According to the Ninth Circuit, the respondent in a state license revocation proceeding may not obtain federal intervention in a § 1983 action rather than defend itself on the state charges and pursue an available state judicial appeal. Thus, in addition to the reasons set forth in the Petition, this split in the circuits militates in favor of granting certiorari.

II. THIS CASE PRESENTS A NOVEL PREEMPTION QUESTION OF GREAT IMPORTANCE IN THE AREAS OF FEDERALISM AND ARBITRATION.

This case presents a federal preemption question of critical importance to state sovereignty: whether private parties are empowered to contract away the statutory remedies of a state regulatory agency. The court of appeals below held that the Federal Arbitration Act preempts a state securities commissioner from ordering restitution with respect to any dispute between private parties who have agreed to submit their disputes to arbitration.[1] If arbitration agreements are deemed to preempt state regulatory actions seeking restitution in the public interest, however, a major function of state attorneys general in the area of consumer and investor protection may be negated through private contract. For this reason, the North American Securities Administrators Association and the National Consumers League have filed a brief as *amici curiae* supporting this Petition. The ramifications of the court of appeals' decision in reducing the ability of states to sanction fraudulent commercial transactions within their borders are likely to become more profound over time as arbitration agreements proliferate among various types of consumer transactions.

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[1] The court of appeals' holding was based on two distinct theories. Judge Greenberg affirmed the district court's order on a preemption theory, but Judge Rosenn concurred instead on a theory of contract law, finding no preemption.

Respondent asserts that the decision below merely reaffirms well-settled authority and that this case presents no novel issue of law. However, the three-way split of the court of appeals panel manifests the complexity of the preemption issue. Indeed, Judge Greenberg (the only panel member agreeing with respondent's preemption theory), began his opinion with this statement:

> This case presents a *novel question* of the relationship between a contracting party's right to enforcement of an arbitration agreement under the Federal Arbitration Act, 9 U.S.C. §§ 1-16 (FAA), and a state's interest in pursuing a remedy of rescission in an administrative proceeding.

(Pet. App. at 3, emphasis added). Judge Nygaard, in dissent, placed even more importance on the court's preemption holding:

> I believe that the opinion of the court unlawfully transfers the authority vested in the Commissioner to private parties. Thus, the boundaries of what the Commissioner, or any other agency with enforcement powers, can or cannot do is not defined by statute, but is limited by the agreements of private individuals.

(Pet. App. at 43). The court of appeals thus viewed the preemption issue here to be distinct from prior arbitration cases where states sought to regulate the arbitration process itself and discriminate against it. *See, e.g., Securities Industry Ass'n v. Connolly*, 883 F.2d 1114 (1st Cir 1989), *cert. denied*, 495 U.S. 956 (1990).

The issue here is whether the federal policy favoring arbitration has any limit, and if so, where that limit is to be drawn. If the respondent's argument is taken to its logical extreme, the Delaware Securities Division would be preempted from bringing any administrative proceeding against Olde on the basis of the Engelhardts' allegations of fraud because the case would involve the same facts and circumstances as those that would be presented at an arbitration between the private parties. If the administrative proceeding were merely a "guise" for a private civil claim, as the respondent asserts (Opp. Br. at i), one would expect that the district court would have enjoined the proceeding. Olde had in fact moved the district court to enjoin the entire administrative proceeding, but the court declined to do so. (Pet. App. at 75). The district court, in its attempt at line-drawing, has thought it appropriate to allow the proceeding to go forward but without one of the State's statutory remedies. This case thus presents the question of where the federal policy favoring arbitration reaches its limit when it runs directly contrary to federalism concerns. It is a critical question that has, to date, been unresolved by this Court.

III. THIS CASE MAY BE DECIDED ON LEGAL PRINCIPLES WITHOUT REGARD TO DISPUTED FACTS.

This appeal may be decided on legal principles without regard to the facts that are in dispute. Respondent's Brief in Opposition relies heavily on alleged findings of fact that were never made by the district court. Olde asserts that the prosecutor acted in bad faith; he made

"extortionist" threats; and he was an agent of the investors working solely for their interest.[2]

Although the posture of this case makes some of the preliminary factual determinations by the district court of questionable validity, the basic findings that frame the two legal issues are undisputed. Two Delaware investors, the Engelhardts, entered into several securities transactions with Olde. As part of that relationship, they signed a pre-dispute arbitration agreement. They subsequently complained to the Delaware Securities Division and alleged that fraudulent misrepresentations were made. The Securities Division investigated and sent Olde a copy of a draft notice of charges. Settlement discussions took place but then broke down. The notice of charges was issued, and the Securities Division sought rescission for the Engelhardts as one of the remedies in the prayer for relief, which also sought a fine and license suspension or revocation. Each remedy was authorized by Del. Code Ann. tit. 6, § 7325(b). Olde responded by filing this action

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[2] Contrary to the respondent's suggestions, the district court made no finding of bad faith or extortionate conduct by the prosecutor. Although respondent argues today that Tupman made "extortionist" threats at their settlement meeting on August 5, 1992 (Opp. Br. at 5), in its August 5 letter to Tupman immediately after that meeting, its counsel (Bruce Campbell) thanked him for "the many courtesies extended" and stated "[w]e understand that you cannot provide legal counsel to the Engelhardts. . . . " (App. 7a, 5a). Mr. Tupman represented the Engelhardts in the district court only because of Del. Code Ann. tit. 29, § 2504(9), which creates a mandatory duty for the Delaware Department of Justice to represent witness-victims who are sued in connection with their role as witnesses for the State.

in federal district court, arguing that the Federal Arbitration Act preempted the imposition of Delaware's restitution remedy.

Those are the only relevant facts which this Court need consider in applying controlling legal principles. This Court's guidance on the law is needed to ensure that a great intrusion on state sovereignty is not undertaken on the basis of the divided, misguided decision below.

CONCLUSION

For the above-stated reasons, and those in the Petition, this Court should grant the Petition for a Writ of Certiorari.

Respectfully submitted,

CHARLES M. OBERLY, III
Attorney General of the
State of Delaware

RICHARD E. FAIRBANKS, JR.
Chief of Appeals Division
Counsel of Record

Delaware Department of Justice
820 North French Street
Wilmington, DE 19801
(302) 577-2500

December 21, 1993

APPENDIX

The attached document was part of the district court record below. (D.I. 6, Exhibit J).

OLDE DISCOUNT

CORPORATION

Member SIPC
LEGAL DEPARTMENT

August 5, 1992

VIA FACSIMILE

W. Michael Tupman, Esq.
Deputy Attorney General
State of Delaware
Department of Justice
State Office Building
820 French Street
Wilmington, Delaware 19801

Re: Case No. 91-07-01

Dear Mr. Tupman:

Thank you for taking the time to meet with Randy Mudge, Rich Tucker and me today. Since the issues are very important to all involved, I want to memorialize the points which we expressed in our discussions.

We understand that the Attorney General's Office agrees that it is in the best interest of all parties that the matter be resolved by OLDE Discount making a payment, in the amount of $15,000.00, to the Delaware Investors Protection Fund, and that the State of Delaware would close the files in this matter, and further, the State would not open or institute any proceedings in the captioned matter. The only disagreement, or sticking point, to resolving this matter appears to be your assertion that OLDE's offer to the Engelhardts, in the amount of

approximately $20,000, "may not be adequate" and that rescission (as opposed to our offer of restitution), in the amount of approximately $52,000 would be "more fair" to the Engelhardts. We believe that the offer which we have made to the State of Delaware and to the Engelhardts respectively is both generous and reasonable under the circumstances and is fully supported by Delaware law.

Regardless of the strengths (or weaknesses) of the merits of their claim, OLDE's offer to compensate the Engelhardts is more than simply a token settlement. The offer of compensation to the Engelhardts is complete restitution for all of the losses allegedly caused by Donohoe while their SNFS stock was held at OLDE Discount. As we explained, the $20,375 offer reimburses the Engelhardts for the full depreciation in the value of their SNFS stock calculated by the cost of their purchases less the market value of the stock on September 6, 1990, the date when the Engelhardts transferred their SNFS stock out of OLDE Discount. At least by that date (and probably earlier), the Engelhardts were fully aware of their claim concerning Donohoe and their putative unhappiness with OLDE. After September 6, 1990, the Engelhardts made a new and independent investment decision to keep (*not* sell) their SNFS stock. On that date, the Engelhardts turned pro active making their own decisions without any influence from either Donohoe or OLDE Discount. They also assumed responsibility for their independent decisions. Surely, OLDE Discount cannot (and should not) be held financially responsible virtually as a guarantor of the investment *after* the Engelhardts removed OLDE Discount's involvement by transfer of the stock out of OLDE. To hold otherwise

would allow the Engelhardts to "play the market" at OLDE Discount's expense. The Delaware Securities Act ("Act") does not contemplate, let alone require such an unreasonable and punitive approach. Moreover, our offer of complete restitution is expressly embraced by the Act. *See* Section 7325(b).

As with any contested matter, the allegations involving Mr. Donohoe are problematical. However, regardless of the strengths or weaknesses of the State's proposed case against Donohoe, we believe that the allegations involving OLDE Discount are tenuous, at best. Rather than discuss the specifics of the allegations as we did in our letter dated June 25, 1992, we share with you two additional observations. First, we note that the nature of most of Donohoe's alleged wrongdoing is not causally linked to the Engelhardts' losses. For example, the allegations regarding disclosure of market-maker status, commissions charged and whether the transactions were "solicited" or "unsolicited" do not appear to have any causal relationship to any claimed losses. Secondly, and perhaps more importantly, many of the allegations regarding Donohoe occurred well-after the Engelhardts transferred out of OLDE their SNFS stock. *See e.g.* State's proposed notice paragraphs 20 and 21. Like our assessment of financial responsibility discussed above, we believe that OLDE Discount cannot (and should not) be held accountable for events which occurred *subsequent* to the September 6, 1990 stock transfer date.

Notwithstanding our views on the overall merits, we remain willing to resolve this matter by again urging that you accept our generous offer of settlement. If the

Engelhardts believe that this restitutionary offer is unacceptable, the State should nevertheless accept the balance of our offer and bifurcate the State's public interests from those of individual private citizens (the Engelhardts).

Apparently, you have some dilemma as to whether you can or should bifurcate the State's public interest position from the private interests of the Engelhardts because you believe that you may have some obligation to administer rescission as provided in Section 7325(b) of the Delaware Code, as amended. We believe that you have no such obligation and may have misperceived the role of the state. *The Engelhardts have opportunities to redress any alleged improprieties.* If the Commissioner's decision under Section 7325(b) was the only remedy available to the Engelhardts, then the State might have some valid concerns about bifurcation, but that is not true in this matter, since the Engelhardts have access to both the arbitration process and state and federal courts to redress any purported wrongdoing.

We urge that the Engelhardts be apprised of our offer to pay them $20,375 in settlement of their dispute with OLDE Discount arising out of their purchase of SNFS stock, and that such offer will remain open for a period of ten days, from the date of this letter. In the event that the Engelhardts refuse our offer then we ask that their attorney, or the Engelhardts themselves, directly advise us that the offer is declined, and they may take whatever action they deem necessary, either in court or in arbitration.

As you know, we have had a nagging concern in our discussions with the State because we do not know

whether the Engelhardts are represented by counsel. We understand that you cannot provide legal counsel to the Engelhardts and therefore we are unable to discern whether the Engelhardts have had the benefit of counsel in evaluating our offer. We believe that counsel would be able to apprise the Engelhardts of the relative merits and risks of litigation [sic] this matter with OLDE Discount.

If the Engelhardts are represented by counsel, we would like to know the identity of that counsel, so that we may directly communicate our offer to their counsel. In the event that they are not represented by counsel, we suggest that they consider obtaining such representation, in order to evaluate and discuss our offer to them.

Finally, in the event that our discussions do not produce a mutually agreeable resolution of this matter, there are a couple of issues which we believe you should consider. As above, these issues do not have as their underpinning any analysis of the respective positions of the State, OLDE, the Engelhardts or Mr. Donohoe.

The application of amended Section 7325(b), in the instant matter, would constitute the imposition of *ex post facto* penalties in violation of the "Due Process Clauses" of the Constitutions of both the United States and the State of Delaware. *See Weaver v. Graham*, 450 U.S. 24, (1981); *In the Matter of the State of Delaware for a Writ of Mandamus*, 603 A.2d 814 (Del. 1992). The acts underlying the State's allegations in this matter, occurred prior to the August 16, 1991 effective date of amended Section 7325(b). Because of the serious concerns about the applicability of this provision, in the instant matter, Section

7325(b) should play a *de minimis* role in the State's decision to settle this matter.

In addition to being *ex post facto*, the application of Section 7325(b) violates the separation of civil and criminal proceedings in the administration of justice, also in violation of due process. We are aware of the previous position of Commissioner Hubbard, (e.g. in the Hibbard Brown matter), wherein he distinguished between the remedial and penal nature of his decision-making process, and we submit that such a distinction is inappropriate in a case where the Commissioner is determining penal and remedial sanctions simultaneously in the same matter. Once penal sanctions are being considered in any single matter, then the matter is penal in nature (for all purposes) and not remedial or civil in nature. Therefore, predicating settlement on both the penal and civil aspects of this matter would be tantamount to using the threat of criminal (penal) litigation in order to settle civil (remedial) litigation, a questionable approach under any state's professional conduct rules. *See In re Ridgely*, 48 Del. 464, 106 A.2d 527 (1954).

Finally, application of Section 7325(b), as you propose would violate the "Supremacy Clause" of the United States Constitution. See *S.I.A vs. Connolly*, 888 F.2d 1114 (1st Cir. 1989) *cert. denied* 110 S. Ct. 2559. See S.I.A. vs. Lewis, 751 F. Supp. 205 (S. D. Fla. 1990.)

OLDE Discount believes that its internal control procedures and supervisory compliance procedures of its sole office in Delaware were at least consistent with custom and practice in the securities industry and all applicable regulations and were properly and fully implemented and

enforced. Absent direct feedback from our customers, there is absolutely no way any securities firm can learn, for example, whether orders which were allegedly solicited were marked "unsolicited." As you know, the Engelhardts conveyed no such advice to OLDE Discount. If we are unable to resolve this matter in a way which is fair to all parties, OLDE must weigh the seemingly unfair costs of doing business in Delaware (i.e. an extraordinary payment in excess of $50,000 to customers who have never complained to us and have attempted to play the market at our expense) against the relatively insignificant profitability of a very small market. Such a harsh choice sends the wrong message to companies doing business in the State. We hope and trust that you will consider this letter in the spirit in which we have conducted all of our dealings with you to facilitate a prompt, fair resolution of this matter.

We urge you to accept our offer of settlement and await your response. We appreciate the many courtesies extended.

Sincerely,

OLDE DISCOUNT
CORPORATION

Bruce A. Campbell
Corporate Attorney